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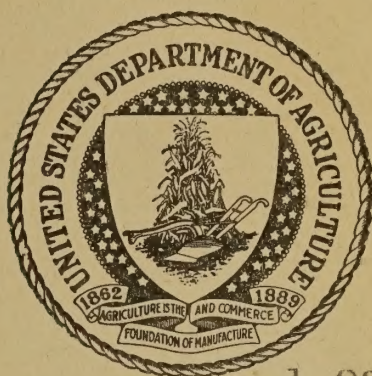
HANDBOOK for FIELD AUDITORS

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**U.S. DEPARTMENT OF AGRICULTURE
RURAL ELECTRIFICATION ADMINISTRATION**

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PREFACE

Among the responsibilities imposed upon the Administrator by the Rural Electrification Act are certain functions which he has delegated to the Finance Division. In carrying out its responsibilities, the needs of the division's portion of the program have given rise to certain well defined objectives, namely, to determine:

1. Whether Government loan funds have been distributed to the borrower's accounts for purposes consistent with the Rural Electrification Act of 1936, as amended.
2. Whether borrowers are complying with the terms of the loan contract, note and mortgage, as well as prescribed policies and regulations.
3. Whether borrowers' records are being maintained efficiently from a financial standpoint, transactions are recorded accurately, and whether revenues are sufficient to meet all charges, including principal and interest payments of the Government loan.
4. Whether borrowers conform to accounting procedures prescribed by REA, and if their loan account records are properly maintained and in agreement with REA records.

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The success of the program must largely rest upon the efforts of field auditors capable of performing an unusual type of accounting service. Their sphere of action comprises:

(1) Electric utility accounting; (2) Municipal and State Government accounting; and (3) Corporate cooperative accounting. Owing to the nature of their work, field auditors must maintain a keen allegiance to the program and the Administrator in order that the interests of the Government may be fully protected.

The purpose of this handbook is to establish uniformity in the performance of field auditors' assignments. It provides a general working plan for each type of audit required as well as instructions for the auditor in conducting his work. The audit standards established herein are based on the requirements of the Administration for the audit program. The auditor is expected to exercise his initiative and judgment in conducting his audit so as to meet these standards.

It has long been recognized that the work of the Rural Electrification Administration auditor is comparable to that of the professional public accountant. This material, therefore,

was developed to conform with both Government regulations and the commercial auditing standards of the public accounting profession.

The revisions and suggestions relating to the various auditing steps result from the many new developments caused by the growth and expansion of REA activities. The procedure in this handbook represents the crystallization of these changes in the requirements of the audit program into minimum auditing standards for the Rural Electrification Administration.

This handbook has been prepared as a guide for new REA auditors and as a reference book for experienced REA auditors. Special consideration has been given to the experience and background of new members of the audit staff and the manner in which they are recruited.

Members of the field audit staff necessarily differ as to experience and ability. Some new auditors have come up from the ranks in the Finance Division, others have previously been employed as bookkeepers for REA borrowers, and some have been recruited from outside the REA field of activity. We have accepted the responsibility for providing training for all new field employees which will assist them in becoming a part of an operating staff capable of meeting REA requirements in a uniform manner.

Parts I and II of the text have been devoted to background material and to a restatement of audit fundamentals and principles, whereas Parts III, IV, and V have been devoted to audit procedures, the audit report, and required auditors' working papers. REA field auditors will find the handbook a reliable and speedy source of information in their daily work.

The main objective which has prompted the preparation of this handbook, beyond that already described, is the need of ascertaining to a conclusive degree that our audit procedure is adequate while simultaneously relieved of operations or processes which will impair the effectiveness of an audit. This further excludes steps incident to the work which might ordinarily be considered valuable but not entirely essential. Every source of information considered helpful has been consulted beyond the actual experience gained during upwards of 12 years, which period disclosed the needs of our program as reflected by the industry represented, and we herewith release this handbook which constitutes the first edition of what we have concluded to be the definition of a *MINIMUM ACCEPTABLE AUDIT*.

June 1948

Jos. F. Marion, Chief
Finance Division

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PART I
INTRODUCTION



HANDBOOK FOR FIELD AUDITORS

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INTRODUCTION

REA OBJECTIVES AND ACTIVITIES

- (1) The Rural Electrification Administration was created by Executive Order No. 7037, dated May 11, 1935. The following year its program was accepted by the Congress and it was reestablished as the Rural Electrification Administration, with the enactment of the Rural Electrification Act of 1936. The Act specifies that its powers shall be exercised by an Administrator who is authorized and empowered to make loans to persons, corporations, States, Territories, and subdivisions and agencies, thereof, municipalities, peoples utility districts and cooperatives, nonprofit, or limited dividend associations organized under the laws of any State or territory of the United States. The agency is to lend public funds to eligible borrowers for the purpose of financing the construction and operation of generating plants, electric transmission and distribution lines or systems for the furnishing of electric energy to persons in rural areas who are not receiving central station service, also financing the wiring of the premises of persons in rural areas and for the acquisition and installation of electrical and plumbing appliances and equipment.
- (2) The construction loans are, as a rule, for the full amount necessary to construct a system and to get it into operation, and the security therefor is a mortgage upon the properties and other assets of the borrower. For the loans to be used for financing house-wiring and electrical and plumbing appliances, the security accepted is usually the notes given to the borrower by its consumers, which notes are pledged as collateral for this class of loans.

REA POLICY WITH RESPECT TO AUDITORS' RELATIONS WITH BORROWERS

- (3) The majority of loans made for construction and for house-wiring and appliances have been made to cooperatives or non-profit organizations. Some loans have been made to municipalities, public power districts, and to private power companies. The management of the business affairs of the borrowers does not come under the control of REA since REA is merely a lending agency for the promotion and development of electrification of rural areas. As such,

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the REA or the U. S. Government has no ownership or financial interest in any of the borrowers except to the extent of the amount of the mortgage or other collateral.

- (4) The Rural Electrification Administration was established by the Congress as an agency to execute a program of rural electrification, primarily by the lending of funds to eligible borrowers for furnishing central station electric service to persons in rural areas. Incidental to this primary objective is the responsibility of safeguarding the loans and of guidance and assistance in the operation of the systems to promote the earning capacity of the properties constituting the security for the loans. REA has not been authorized to acquire, construct, own or operate electric systems (except properties acquired by foreclosure or other sale, within specified limitations) or to serve as operator directly, or indirectly of electric systems of borrowers.
- (5) As previously stated, the borrowers are independent corporations or organizations who control and manage their own business affairs. The majority of borrowers are cooperatives or nonprofit organizations. At first the borrower is more or less dependent on the accumulated experience of REA for this guidance and assistance. This service should, however, diminish during the life of the loan contract and in proportion as the borrower gains experience.
- (6) REA's relationship with borrowers is, therefore, that of an adviser and guide, and the auditors must bear continually in mind that it is contrary to administrative policy for any REA representative to *demand* action where action is indicated. It is the auditors' job first to secure factual data concerning the financial and managerial affairs of the borrowers which will insure a comprehensive audit report, and secondly, to educate and persuade the borrower as to the need for correctly recording transactions to present to its management and to REA a true picture of results of its operations. Auditors should realize that they are merely advisers and consultants in addition to their normal duties as auditors.
- (7) During the course of an audit, at a special assignment, or on other occasions, should the borrower raise a question as to why certain procedures are required, the auditor should tactfully explain the reasons for REA policies. The auditor should make it clear that REA welcomes suggestions for improvement of REA policy and procedures.

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If the auditor does not have the information required, he should inform the borrower that he will endeavor to secure an answer to the query or that he will report the matter to the Washington office.

- (8) It should be borne in mind that the REA auditor must conduct himself in the manner generally followed by public accountants, that he is a fact finder, and that he does not possess administrative authority. The REA auditor is, however, expected to report any condition which he deems to be out of line with good accounting and sound business practices within the scope of the REA program, policies, procedures and regulations.

FUNCTIONS OF FINANCE DIVISION

- (9) The Finance Division was created and established on September 16, 1937 by General Order 59. Its functions may be briefly stated to consist of responsibility for records and accounts pertaining to procurement of loan funds and their repayment; for records and accounts pertaining to loans made to borrowers and their repayment; for assistance to borrowers in respect to their financial records and accounts; and auditing of borrowers' accounts and preparation of financial reports and statements. These activities may be divided into three main functions, as follows: 1. Fiscal Accounting Functions; 2. Commercial Accounting and Auditing Functions; 3. Advisory and Instructional functions.
- (10) 1. *Fiscal Accounting Functions:*
- (a) Control and maintenance of allocation budgets of loan funds and revisions thereof. (The auditors' responsibility herewith is to verify that the total of allocation budgets is properly recorded on the books of the borrower.)
 - (b) Review and approval of borrowers' requisitions in reference to approved budget for advance of loan funds. (The auditors' responsibility herewith is to verify that the loan funds, as shown by the approved Financial Requirement Statements, are properly reflected on the books of the borrower.)
 - (c) Preparation of billings and recording of collections of borrowers' interest and

principal payments and maintenance of accounts and records with reference thereto. (The auditors' responsibility here is limited to a determination as to whether or not the borrower is checking computations of amortization statements and verifying the accuracy of interest computations.)

- (d) Maintenance of records of loan fund transactions including appropriations, advances, and collections of interest and principal repayments. (The auditors' responsibility herewith is to reconcile the balances as shown by the quarterly interest statements with the books of the borrower.)
- (e) Custodian for all loan documents such as contracts, notes, mortgages, bonds, and other securities.

(11) 2. *Commercial Accounting and Auditing Functions:*

- (a) Design of uniform system of accounts of borrowers and formulation of accounting procedures and revisions thereof. (It is the auditors' responsibilities to correlate the accounting systems and procedures maintained by borrowers with those instituted by REA and to suggest changes to the Washington office if the auditor deems them necessary.)
- (b) Review and approval of expenditure reports and receipts for disbursements to account for loan funds in accordance with existing REA instructions. (The auditors' responsibilities in connection with disbursements of REA funds are to verify the propriety of each disbursement from the construction fund and to determine whether it has been disbursed for approved purposes as set forth in the loan contract or other documents. Where unallowable or improperly supported disbursements are discovered by the auditor, the borrower should be requested to reimburse REA Construction Funds during or shortly after the audit.)
- (c) Approval of accounting and related financial aspects of borrowers' utility plant through review and approval of contract and force

account inventories, construction work orders, retirement work orders, construction cost records, and inventories of properties acquired by borrowers, and adjustments thereto. (The auditors' responsibility in connection with this function is to ascertain the propriety of charges to work in progress as recorded on the borrowers' records, and the accuracy of distribution of these charges to plant accounts.)

- (d) Conducting audits of the books and accounts of the borrowers and certifying to the financial statements and accompanying comments. (This is the primary function of the auditor. The details of the different audits, assignments to auditors, purposes of audits, and the methods pursued to accomplish the aims herein expressed, are set forth in the following chapters of this manual.)

(12) 3. *Advisory and Instructional Functions:*

- (a) Assistance to borrowers to maintain recommended accounting principles and procedures through manuals, memoranda, field visits, conferences, and correspondence: (It is the duty of the auditor to assist borrowers to maintain their books and accounts in accordance with recognized principles of accounting and to point out the reasons for installing and maintaining the necessary records. Auditors are expected to make suggestions in their reports for modifications of procedures recommended by REA if they find they are in need of improvement, or for installation of procedures if the auditor feels that they should be recommended to borrowers.)
- (b) Assistance to borrowers on problems having accounting and related financial aspects such as preparation of insurance claims, reports for regulatory bodies, special reports, defalcations, etc. (The auditor will receive special instructions to make investigations of the borrowers' books and records and to compile the required data, information

and report for submission to his Regional Office. The resulting reports will then be issued by the Regional Office direct to the borrowers.)

- (c) Analysis of audits and preparation of reports for use of borrowers and other divisions of REA. (All working papers and reports are compiled and prepared by the auditor while in the field. The analysis and distribution of the reports are a function of the Regional Office of REA.)
- (d) Consultant to other divisions of REA on problems having accounting and financial aspects, such as acquisitions, sales and transfers of property, advance of funds, refinancing notes, records and forms, valuations, insurance claims, tax reports, personnel, etc. (Normally a function of the Regional Office but dependent upon the accuracy and completeness of the working papers and reports compiled and prepared in the field by the auditor. The auditors may be called upon to act in this capacity in the field in which cases special assignments will be made to them.)
- (e) Preparation of periodic and special reports on financial matters concerning loan funds transactions and estimates of funds required for advances for submission to U. S. Treasury Department, General Accounting Office, and Department of Agriculture.
- (f) Assistance to borrowers by instructing their personnel on accounting matters through the medium of the REA correspondence course containing the basic fundamentals of electric utility accounting, as well as specialized and technical training concerned particularly with REA system of accounts.
- (g) Render bookkeeping assistance to borrowers. (This function does not normally contemplate doing the bookkeeping work for the borrowers. When performed, it is assumed that this work is done to a limited extent and then for illustrative purposes only, as a guide for the future. To continue to perform bookkeeping work for borrowers after they are

established not only reduces audit production, but does not accomplish one of the basic aims of REA which is to assist our borrowers in becoming self-sufficient. Fundamentally, it is essential that we show the way to borrowers in their conduct of their bookkeeping operations with written instructions when necessary, supplementing the publications and memoranda furnished by REA, indicating the application of those data to the specific problems confronting the individual borrowers.)

FUNCTIONS OF OTHER LINE DIVISIONS

- (13) In addition to the Finance Division the other line divisions which have been established within the organization of REA to carry out the intent and purposes of the Rural Electrification Act of 1936, as amended, and the policies as issued by the Administrator are:

1. Applications and Loans Division
2. Engineering Division
3. Management Division
4. Power Division

A brief statement of the functions of each of these divisions follows:

- (14) *Applications and Loans Division.* Within the scope of general REA programs and directives, this division is responsible for development and execution of plans for: advising and assisting sponsors seeking rural electric service to develop valid organizations; advising and assisting sponsors and borrowers in the conduct of unelectrified farms and preallotment surveys for orderly extension of rural electrification and in the preparation of applications for loans for such purposes as may be made pursuant to the Rural Electrification Act of 1936, as amended; determining self-liquidity of loan applications; certifying and recommending for approval of Administrator applications for all types of loans; consummating loan agreements, recommending extensions of outstanding notes except under Section 12 of the Act, as amended; encouraging and stimulating utilization of electric power through advising and assisting borrowers

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in activities concerned with maximum beneficial use and procurement of electrical appliances and equipment and with development of rural industries; establishing and conducting wiring and plumbing educational programs.

- (15) *Engineering Division.* Within the scope of general REA programs, policies, procedures and standards, this division is responsible for the conduct of all REA activities pertaining to rendering engineering advice and assistance to borrowers in the design, construction and technical operation of rural electric distribution systems and related facilities. It recommends approval of the proposed and completed distribution construction, and carries out a program of inspection with respect to the quality of poles, pole inspection service, and the compliance with standards for pole treating processes.
- (16) *Management Division.* Within the scope of REA programs, policies, procedures and standards, this division conducts all REA activities pertaining to advice and assistance in the general management of rural electric distribution cooperatives and locker plant cooperatives; this includes rendering service and assistance on business management, operating and financial performance, maintenance of proper organization, personnel, retail rates, labor relations, insurance, taxes, transfer of property between borrowers, work procedures, office management and other business management matters.
- (17) *Power Division.* Within the scope of general REA programs, policies and procedures this division formulates, plans, and develops programs concerning all aspects of supplying power, either through purchase or generation, to be distributed to consumers. It advises and assists borrowers in the design and construction of generating plants and transmission facilities. In addition, it makes recommendations to borrowers on such matters as the purchase of power, wholesale rates, and power contract negotiations. It is the responsibility of the Power Division to provide general management advice and assistance with respect to central generation and transmission systems and advice and assistance in the operation and maintenance of all generating plants and transmission systems.
- (18) The principal activities of the line divisions are in the field where direct contact is had with the direc-

tors, officers and personnel of the borrower and with the public in general by REA fieldmen. These REA fieldmen have a primary responsibility for their specific divisional activities. Incidental to the performance of their activities, problems may arise affecting the functions of other divisions. If REA has issued specific written instructions on the subject, the fieldman may point to these written instructions as a guide in solving the problem. If, on the other hand, written instructions have not been issued and the problem is one requiring interpretation of another division's functions with which he is not familiar, the fieldman should confine his advice and assistance to those problems concerned with his primary responsibilities only, and should report all problems discussed to his superior for transmittal to the REA division concerned. In addition to the five line divisions there are four other divisions rendering directly or indirectly specialized services to REA borrowers. These divisions are Personnel, Administrative Services, Information Services, and Technical Standards.

- (19) *Rural Electrification Division - Office of The Solicitor.* Legal work relating to REA is under the direction of an Associate Solicitor. In Washington legal services are furnished by two divisions and there are nine regional offices in the field. The Electrification Loans Division performs legal work relating to loan proposals, the effectuating and validating of loans, and determines legal sufficiency of the security for loans. It prepares loan agreements, notes, mortgages, bonds and trust indentures, also all required municipal ordinances and resolutions, incident to the long-term financing program of REA. It reviews all documents pertaining to such matters as debt refunding, reorganizations, mergers, consolidations, acquisitions, and conveyances. It handles problems involving the maintaining of loan security and the enforcement of security rights. The Electrification Operations Division performs all legal work necessary to protect the interests of the Federal Government in the administration and enforcement of Section 4 loans in relation to borrower contracts with others, rights-of-way, permits, franchises, land titles, insurance, etc., incident to construction. It also handles the legal aspects of all matters touching upon the security and safety of loans, when such matters arise from operations, litigation, or opinions by borrower attorneys.



PART II
THE REA AUDIT PROGRAM

THE REA AUDIT PROGRAM

PAR. THE AUDIT APPROACH

- (20) While field auditors of the Rural Electrification Administration, from an employment standpoint, are not primarily engaged in professional accounting, they are, nevertheless, bound by the ethical standards and practices of their profession and by the technical requirements of accounting science. *They must also adhere to a single, integrated, coordinated and planned audit program.* Teamwork in the strictest adherence to this plan and program is one of the invariable requirements in the audit.
- (21) The uniformity of audit subjects, objectives and purposes make it possible to standardize each step of the audit plan, outline specifically much of the mechanics and develop bases on which auditors can apply judgment and accounting principles to anticipated situations. Much can be made routine, but complete elimination of the human element is never possible. The standards outlined herein are intended to provide uniformity and if adhered to, will result in a greater number of high quality reports. In the REA field audit work where there is in effect a uniform system of accounts, and a practically uniform set of problems to be dealt with, the audit procedure can be specified in considerable detail in performance instruction.
- (22) *Audit Objectives.* The general purpose for making REA audits is to determine the financial condition and operating results of the borrowers; and to determine adherence to REA requirements with respect to accounting records and procedures. Each audit conducted will require that the auditor use his technical knowledge of accounting in the performance of the particular examination involved. The following, as a general rule, are the objectives of examinations of the records of REA borrowers:
1. To determine and report the status of REA loans to the Administrator of REA and the borrower.
 2. To determine the financial condition and results of the borrower's operation since they relate to the borrower's ability to repay its obligation to REA.

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3. To furnish REA and the borrower periodic reports on the financial condition of the borrower as a guide to better management.
4. To detect and prevent the possibility of fraud.
5. To determine the adequacy and accuracy of records and whether there has been adequate and effective internal check and control.
6. To detect errors for the purpose of correcting the records themselves and for giving instructions to the bookkeeper regarding better methods of recording the business transactions of the organization.
7. To enable the borrower to prepare verified state and federal financial reports.
8. To inform the management concerning trends and the manner in which the business is being conducted, as reflected by the records.
9. To determine assets and liabilities resulting from the sale or acquisition of property and make proper entries.
10. To determine construction costs and make proper distribution to the capital accounts.
11. To determine borrower's compliance with the terms of the loan contracts, agreements, and approved procedures.
12. To verify the propriety and budget classification of disbursements from construction loan funds and correct the borrower's reports to REA.
13. To determine the amount of construction financed from the general fund of the borrower.

(23) *The REA Audit Program.* After a cooperative has been organized and the Rural Electrification Administration has approved a loan to it, an REA field auditor will visit the borrower for the purpose of establishing the record-keeping system. At this time the auditor will have the opportunity to be of greatest assistance to the borrower and to the Rural Electrification Administration in setting up the approved bookkeeping procedures. The help and guidance given to the borrower's

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personnel will influence the efficiency of their record-keeping system for many years.

- (24). At some later date, preferably while the power system is under construction, the auditor will be instructed to visit the borrower's office again to review the progress of the personnel in applying recommended accounting procedures. At this time, the auditor will audit the books and records to date, as instructed, and he will have further opportunity to answer specific questions arising from experience of the office personnel in the maintenance of the accounting system.
- (25) After the electric system has been energized, succeeding visits will be made to the borrower's office. The auditor will conduct other audits, as instructed, and will also distribute the costs of completed construction previously charged to work-in-progress accounts to the proper electric plant accounts on the basis of the approved inventories.
- (26) When the auditor finds that the records of the borrower are not properly maintained because of unusual circumstances, it may be necessary for him to conduct a complete examination of all financial transactions of the borrower during the period under audit. This is known as a detailed audit. Greater emphasis on the proper instruction of the borrower's personnel will generally be required during the course of an audit conducted under these conditions.
- (27) It may be necessary for an auditor to visit the office of the borrower for a limited time to conduct an interim audit consisting of a review of the receipts and disbursements of the REA construction funds and the distribution of the charges and credits to the work in progress accounts and to the several plant accounts. Such an audit is performed by an auditor under instructions embodied in the construction audit assignment.
- (28) From time to time the auditor will be assigned to conduct audits of specific portions of the borrower's records, such as a review of payments made to outside contractors and engineers, and to prepare certain reports on various subjects involving accounting records and procedures. These audits will be made in accordance with instructions contained in the special audit assignments.

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- (29) In visiting the borrower's office for any of the purposes mentioned, the auditor should bear in mind that his work is important to the proper functioning of the individual accounting system under review and that, through the information he provides for managerial purposes, his activities contribute greatly to the success of the Rural Electrification Administration program as a whole.
- (30) *Assignment Schedule.* Before assigning field audit work to the auditor, the supervisor will determine the general nature and type of work required at the borrower's office. This information is used in the preparation of an assignment schedule, which sets forth the type of assignment and any special instructions to the auditor regarding the work to be done. The assignment schedule serves as an official authorization for the auditor to proceed with the necessary work. It is the duty of the auditor to carry out these instructions and to comply with all requirements for each type of assignment as presented in this handbook.
- (31) When two senior auditors are assigned to perform an audit jointly, the supervisor will designate the individual who is to be in charge.
- (32) In special cases unforeseen conditions may necessitate revision of instructions on the assignment schedule. For example, records may be so incomplete that a detailed verification of the accounts is necessary to secure the desired information. In such cases, the auditor should communicate with his supervisor and obtain approval to do the additional work before starting on the unassigned tasks. Securing prior approval is important, since the time of the audit staff must be allocated on an overall basis. The observations the auditor makes to his superior concerning the requirements of the audit in question should be based upon a complete analysis of the situation at hand, together with a careful estimate of the amount of time required for the work.
- (33) *Notice to Borrowers of Anticipated Audit.* At the time each general assignment is made, a letter may be directed to the borrower, by the Regional Head or Field Supervisor, advising that an audit of the borrower's records will be made by a member of our field audit staff in the near future; if the approximate date of audit is known, the borrower may be advised of such

date. The letter should call attention to the advantages to be gained by the borrower, as well as the auditor, by having certain records current and immediately available for the use of the auditor. The letter may include a list of the items which will be required by the auditor. A suggested list of such items is contained in Paragraph No. 117.

- (34) *Auditor's Responsibility.* The primary responsibility of the auditor is to conduct a study of the accounting records of the borrower which will disclose all possible information in regard to its true financial condition. The auditor is responsible for conducting this study in a manner which will determine the accuracy of the accounting practices used and will disclose defalcation. While this detection of defalcation is not the major purpose of the audit, the auditor has a definite responsibility for conducting his work in a manner that will disclose these facts.
- (35) It is also the responsibility of the auditor to present complete and accurate statements of the financial condition of the borrower disclosed by this study which is supplemented by comments relating to the audit. These audit comments should state the pertinent facts, both favorable and unfavorable, in regard to the financial statements and conditions observed as to adequacy of records and accounting procedures. The auditor should also comment on such of the borrower's business practices as are pertinent to the financial report. Although the auditor is sometimes required to make a payout status analysis reflecting ultimate repayment of the government loan, he should not place himself in the role of a prophet. Any statements made in his audit report in this or any other connection must be based on facts revealed by the records and must be so stated as not to be misleading.
- (36) It is essential that the work on one assignment be completed before the auditor moves on to his next assignment. All working papers and comments should be completed while the auditor has access to the data available in the borrower's office.
- (37) *Professional Attitude and Demeanor.* The field auditor is expected to conduct himself, both during official working hours and in his leisure time, in a manner which will command respect from those who have occasion to with him or observe him. In a broad manner of speaking,

the auditor is the employee of the people living in the community where he is assigned to audit the records of a borrower of the Rural Electrification Administration and he must expect from them the same keen appraisal of his work that he would receive from any exacting employer. His conduct must be above reproach. If it is not, he is subjecting himself to the suspicion that his audit work is of the same caliber as any lax personal habits or occasional shortcomings exhibited. The auditor's personal conduct should be such that the integrity and impartiality of his investigations, findings, and reports may be beyond question.

(38) The following points are not all inclusive, but should be helpful to field auditors in determining conduct during performance of assignments:

1. Always be neatly dressed.
2. Both during and after working hours, conduct yourself with decorum.
3. Ask no favors in violation of established Departmental rules and regulations and accept none.
4. Be honest in your convictions, free from prejudices, scrupulous in your actions.
5. Be loyal, self-reliant and dependable in the performance of your work.
6. Be sincerely cooperative during the performance of your audit. You can be friendly with the office staff without compromising your integrity and without irritating them by announcing that the ethics of the auditing profession requires the stand-offishness on your part.
7. Contact the manager immediately upon arrival at the borrower's office. At this time ask him if he prefers advice to be given to the bookkeeper only or to himself and the bookkeeper jointly.
8. Be cautious in your criticism of the borrower's office procedures and in recommending changes in office routines.
9. Observe the ordinary office hours of the borrower so as to offer the least possible disruption

to the routine of the office staff. Be prompt in getting to work and work at least the minimum hours set by regulations.

10. In cases wherein it becomes necessary to work alone in the borrower's office, be sure that all monies, bonds and securities are locked in the safe or vault.
 11. Do not accept any cash receipts from patrons at any time.
- (39) *Procedure Upon Arrival at Borrower's Office.* Upon arrival in the community in which the borrower's office is located, if during office hours, it is expected that the auditor will immediately visit the borrower's office. The auditor should introduce himself to the office receptionist and request an interview with the manager before starting the work assigned.
- (40) If it is the auditor's first visit, he should spend some time explaining the purpose of the visit and learning the general problems which are in need of attention in connection with the audit. There may be instances in which the manager cannot be located immediately, in which event the auditor should explain the purpose of his visit to the employee in charge of the office. Pending communication with the manager, the auditor can well spend his time in observing the office routine in conducting the daily business. Much of the preliminary study of the borrower's office procedure can be undertaken by the observation of work performed by the various employees. A discussion of problems presented by the office personnel will also aid the auditor in his study of the borrower's accounting procedure. The actual performance of the audit procedures should not be started, however, until the manager has been contacted. If the manager is expected to be absent for an extended period, it must be assumed that he has delegated authority to the person left in charge of the office, and this latter individual should be interviewed with reference to beginning the audit.
- (41) *Relations with Borrower's Personnel.* The field auditor must avoid placing himself in the position of a temporary unwelcome employee of the borrower, but must preserve complete independence without antagonizing the office staff. He must carefully evaluate the importance of all matters within his jurisdiction which arise

during the audit. He should avoid creating ill feeling on the part of the borrower's personnel by making important issues out of trivial matters but he should be firm in his stand concerning things of consequence involving important principles.

- (42) The auditor must be careful not to assume the attitude that records are kept by the borrower primarily for the purpose of audit. Likewise, procedures followed in maintaining these records are not primarily designed for the convenience of the auditor. Therefore, it is extremely important for the auditor to evaluate these procedures according to accepted business practices and not according to his personal opinions. The auditor should be tactful in suggesting changes in procedures which are found to be wholly inadequate. A word of caution is proper at this time to the junior or assistant auditors working under the supervision of a senior auditor with respect to their conduct during an assignment. The junior or assistant auditor should always avoid any discussion with the bookkeeper or manager on matters relating to the records without the knowledge or consent of the supervising auditor. Any suggestions must be practical, follow accepted practices and must be in accord with other procedures in effect in the borrower's office. The auditor's suggestions concerning office procedures must be kept in the form of recommendations since he is not authorized to insist on procedural improvements. The method to be followed in making these recommendations will be found in paragraph 47 of this manual.
- (43) No manager likes to have the details of his business known to anyone other than the members of his own staff. Therefore, one borrower's financial condition or progress should never be divulged to employees of another borrower or outsiders. The auditor's attitude here should be one of holding in strictest confidence all facts learned during the audit. Those facts may be divulged only to the Rural Electrification Administration; to the chosen representatives of the borrower; and in a court of law when acting as a witness. This same principle applies to comments on the condition and adequacy of the borrower's records, office procedures followed, and the conduct or work of representatives of the Rural Electrification Administration who previously visited the borrower's office. When you desire to point out or describe a very worthwhile practice followed by another borrower, the latter should not be identified.

- (44) Under no circumstances should the auditor be assisted in his work, in the borrower's office, by anyone other than a qualified employee of the borrower or REA. The auditor may, with the approval of the manager, request the bookkeeper or other employee of the borrower to prepare special schedules, summaries, or other details but these must be checked and verified by the auditor. Paragraph 117 contains a suggested list of items which the borrower's personnel should make available to the auditor.
- (45) In his relations with the borrower's personnel, the auditor should be firm but not harsh. It is never advisable to incur their ill will by assuming a dictatorial attitude or by a show of authority. The auditor can help establish good working relations with the manager and bookkeeper by causing a minimum of disruption of the normal work of the office. This can be implemented by the arrangement of work so as to use records and books at a time convenient to the office staff. The auditor should give consideration to the normal work flow of routine business when planning his audit program so that the borrower can keep the records in a current status during the audit. The borrower should not be advised to withhold monthly reports, prepared for the Rural Electrification Administration, until the audit is completed. However, the borrower should be instructed to submit amended reports at the close of the audit when necessary. The auditor should not request borrower's personnel to permit him to take any of their records from their office for his convenience in working in his hotel room. Audit work should be performed at the borrower's office and not at the hotel.
- (46) The auditor should never hesitate to admit lack of knowledge on matters not familiar to him, and should not give offhand opinions on matters with which he is not entirely conversant.
- (47) *Recommending Changes in Procedures.* During the course of an audit, the auditor may have discovered that the borrower uses certain bookkeeping procedures or office routine which are not in accordance with REA recommendations. He may also find that the borrower's methods are not complete or are otherwise lacking in sound accounting principles. While it is the duty of the auditor to make suggestions or recommendations for the improvement of the records and changes in the procedures, the auditor must be extremely cautious in suggesting any changes and he must use tact in offering any opinions.

- (48) Prior to the auditor's completion of his audit, or at least prior to his departure from the borrower's office, he should discuss the condition of the records with the manager and present recommendations for the improvement of the accounting procedures to him. If the methods used are not in accordance with REA authorized and published procedures, the borrower should be requested to make the necessary changes. However, in making suggestions in any other procedure, the auditor should first ascertain how the particular procedure was developed. If it should be disclosed, for instance, that a previous REA auditor had suggested the present procedure now found lacking, it is deemed advisable for the auditor to discuss the matter with the Regional Head or Supervisor before making any suggestions for any changes, thereto.
- (49) Auditors should refrain from making any statements which would reflect on the abilities of any other REA employee. Care should be exercised in making any statements which are contrary to administrative policies. Such actions could cause the borrower to lose respect for the REA program and for the man making the statements.
- (50) If the auditor finds it necessary to comment adversely concerning any of the borrower's personnel or activities, he should tactfully discuss such matters whenever possible with the manager before he leaves the borrower's offices. This will afford the auditor an opportunity to present a clearer picture of the matter in his audit report.
- (51) After discussing the condition of the records and recommending improvements in the bookkeeping and accounting procedures, it is essential that the auditor prepare a written statement giving a resume of the matters discussed and suggestions offered. This statement may be forwarded to the manager at a later date but it is preferable for the auditor to give it to the manager prior to his departure from the borrower's office, if such action is authorized by the auditor's supervisor. Such a statement given to the manager gives him a visual picture as to what conditions need attention and what is recommended to improve the situation. These recommendations should also be noted in the audit report.
- (52) *Attendance at Board Meeting.* Ordinarily field auditors are not expected to attend borrower's boards of directors' meetings for the purpose of discussing the results

of the audit before it has received final review and approval by the Regional Head, Finance Division. In those instances where a borrower specifically requests the field auditor to discuss the preliminary conclusions of the audit with the board of directors, the field auditor may do so provided the auditor has clearance with the Regional Head, Finance Division. If clearance is given to the field auditor, his comments should be confined to:

- (a) A statement that the conclusions are preliminary pending final review and approval,
- (b) Factual data of an accounting and financial nature,
- (c) The necessary corrections recommended to make the borrower's records more accurate or complete.

- (53) *Contacts with Other REA Personnel.* During the course of the auditor's visit, other field representatives of the REA staff may have occasion to call at the same office. Friendly contact with the members of the field staff of other divisions of REA is desirable and should never be avoided. This does not mean that the auditor is expected to discuss the purpose or findings of his audit with other representatives, but general information which appears appropriate should be furnished such representatives as a matter of rendering assistance to them. At the same time, general information obtained from other representatives may prove helpful to the auditor. All field representatives should be interested in their primary objectives--success of the REA program in the broadest sense.

AUDIT PERFORMANCE

- (54) *Audit Performance as Influenced by Proper Planning.* This handbook deals largely with the procedures for conducting audits---the "WHAT" phase of the auditor's responsibility. The "HOW" of his activity is of equal importance and is represented by his attitudes and methods.
- (55) Our auditors are expected to follow as closely as possible the methods employed by public accountants which lead to the accomplishment of objectives without waste of energy. Auditors should work at high speed but not

under pressure. High speed arises naturally from handling operations in the simplest and most direct manner, whereas the performance of work under pressure ordinarily results in doing things the hard way because of excitement.

(56) *Planning Work.* It is, therefore, obligatory on the part of the auditor to lay out his work in advance. Time consumed in this manner is by no means wasted, since he constructs the "assembly line" on which the "growing product" becomes completed, and as his work progresses, there is no hindrance or delay caused by certain unfinished operations which should have been provided for in advance. Lack of predetermined attention to such matters may easily become the reason why audits require a longer period than can be justified.

(57) A few illustrations should help to solidify in the mind of the auditor precisely what is meant.

1. The auditor's *work sheet* prepared in advance carefully lists all of the general steps which he will be required to follow in the conduct of his audit. The items listed have previously been arranged as to logical sequence and relative importance to each other. The determination in advance of what will be needed to carry on the "how" of this phase of the work with the least delay becomes the responsibility of the auditor.
2. As an audit progresses, there are undoubtedly matters which require discussion with cooperative personnel. It would be supreme folly for the auditor to suddenly stop work in each instance the moment each new subject presents itself and immediately begin a discussion of that subject. This method leads to a complete cessation of his work, and interrupts the person addressed. Consequently, we note two errors of commission, both of which must of necessity react unfavorably, first as to the bad reaction on the part of the office personnel, and secondly, the creation of a rather uncomplimentary estimate of the auditor's ability to direct his own activities. List the items when discovered. Arrange a suitable time for their disposition, thereby avoiding the situation such as herein described. The work of the auditor can be

compared to that of a general who prepares for the siege of an important military position. To make victory certain, he determines far enough in advance everything that can possibly be needed in order to achieve his goal. This includes necessary manpower, equipment, supplies, the removal of any and all obstructions in advance, and the timing of subsequent various steps in a manner which will eventually lead to the accomplishment of the objective.

(58) In the justification of the field personnel required, there are two fundamental questions which must be answered:

1. Are we conducting our audits in a manner which will be restricted to the performance of necessary work for the completion of a satisfactory audit?
2. Is the performance of the work itself conducted effectively so that there can be no legitimate criticism of the manner in which the work is performed?

(59) Strict adherence to the above will introduce into the daily occupation of the auditor a feeling of satisfaction which results from greater accomplishment and efficiency in the fulfillment of his responsibilities. Auditing has been designated as a profession by the courts for some time. Any profession calls for personal service. Personal service implies the ability to perform what is expected in the best manner possible. We know of no profession which automatically guides one so effectively into the conscious need of unceasing improvement in performance as the auditing service rendered to REA cooperatives. It is through this channel that the auditor cannot possibly become an automaton but on the contrary is permitted all the leeway necessary in the expression of his personal ability without restriction.

(60) In conclusion, it is well to impress that this subject has been found so fundamental that it has become the basis for rating field auditors by the addition of a new element, namely, "Effectiveness in organizing the work incident to the conduct of an audit."

TYPES OF AUDITORS' ASSIGNMENTS

- (61) *Balance Sheet Audits.* The balance sheet audit consists of the verification of all balance sheet accounts comprising assets, liabilities, memberships, patrons' capital and reserves, together with a test-check of the revenue and expense accounts. Prior to the time that the borrower's electric power system has been energized, the balance sheet audits involve, (a) installation of bookkeeping and accounting records, and (b) verification of assets, liabilities and membership accounts. Subsequent to energization, the revenue and expense accounts, previously installed, would be added to show the results of operations. In order to clarify the duties and responsibilities of the auditor under these circumstances, and to explain the work to be done by the auditor, the balance sheet audits are of two types, namely: 1. Installation Assignments and 2. Operations Assignments.
- (62) *Installation Audit Assignments.* In installation audit assignments the REA uniform system of accounts is introduced and established. The various books and accounts are set up and the transactions to the date of the audit are recorded under the supervision of the auditor. Information is given to the borrower's personnel regarding approved REA procedures, purposes and use of accounting forms and books of accounts, and importance of proper maintenance of records. A detailed and complete explanation of proper accounting methods and procedures given at this time will effect a saving of time and effort in subsequent audits. It is very important that the auditor thoroughly understand the general plan for this work so that the maximum benefits can be obtained.
- (63) *Audit Plan.* The general plan which follows will serve as a guide in performing installation assignments:
1. Install the borrower's accounting system in accordance with the REA uniform system of accounts. This includes establishment of the general ledger with account numbers and titles, the journal, the required cash registers for all funds, and other books of original entry.
 2. Inform the bookkeeper on all phases of record-keeping and REA procedures. The bookkeeper's education, experience, and displayed ability

should be considered in determining the method of construction to be followed. If deemed necessary, the auditor may undertake the bookkeeping work, such as recording cash receipts and disbursements, for one month, explaining to the bookkeeper the methods used. This will give the bookkeeper actual illustrations of the procedure involved. After recording one month's transactions in the cash records and journal, the auditor should perform the mechanics of posting the summaries to the general ledger accounts, informing the bookkeeper on procedures involved during the operation. After completing the recording of one month's transactions, the auditor should have the bookkeeper record the ensuing months' transactions under his guidance. After this work has been completed, a trial balance should be taken under the supervision of the auditor. This work will give the bookkeeper actual experience in the mechanics involved in the recording of daily transactions and in posting the general ledger.

3. Explain the proper maintenance of subsidiary records to the bookkeeper. Since the membership records are the most important of subsidiary records at this stage of development, careful attention should be given these records. A detailed record of the amount received from each member or applicant, including the name, address and membership certificate number or application number, should be maintained in ledger or card-record form. If deemed necessary, the auditor should prepare the individual record cards or ledger sheets for the first month's transactions, explaining to the bookkeeper the proper method of reconciliation of each month's entries. The bookkeeper should then complete the subsidiary records for each subsequent month under the guidance of the auditor. Emphasis should be placed on monthly reconciliation of these records. The manager should be informed of the importance of issuing the membership certificates as soon as practicable and of continuing the issuance of these certificates each month thereafter in accordance with the by-laws of the borrower cooperative. Specific advice should be given by the auditor regarding the proper establishment and maintenance of subsidiary records for the following: notes and accounts receivable, perpetual inventory record of materials and supplies,

prepaid insurance premiums, accounts payable, consumers' deposits, consumers' advance payments, depreciation, meters, transformers, construction work in progress accounts, plant accounts, consumers' advances for construction and contributions in aid of construction.

4. Call the bookkeeper's attention to the fact that a proper filing system should be established, offering practical suggestions.
5. Determine what provision has been made for safe-keeping of the following data: Minute Book, Articles of Incorporation, By-Laws, Executed Copies of All Contracts, Notes and Mortgages, Insurance Policies and Bonds, Membership Certificate Books, General Ledgers, Books of Original Entry, etcetera.
6. Prepare bank reconciliation of all cash funds.
7. Reconcile cash on hand by physical count.
8. Invite open discussions on accounting problems relating to the cooperative.
9. Give further instructions to the bookkeeper on how to obtain and account for REA funds. Review the Finance Division bulletin covering this subject with the borrower's bookkeeper. Assist in the preparation and submission of all delinquent requisition and expenditure reports which are to include all disbursements from REA construction funds to the date of the audit.
10. Prepare a summary of REA construction fund transactions by budget purposes in accordance with the approved form for presentation.
11. Prepare a working trial balance and related exhibits.
12. Analyze or schedule balance sheet accounts.

(64) *Audit Report Requirements.* The following data are generally required to be submitted in an audit report covering an installation assignment:

1. Financial statements with comments thereon.

2. Auditor's general comments.
3. Field Activities Report. (Form ADM-36)
4. Audit table of contents.
5. Audit assignment schedule.
6. Breakdown of time consumed in various tasks.
7. Working trial balance with supporting exhibits and schedules which are applicable to the accounts in use at the time of the audit. Model exhibits and schedules are described in Part V of this handbook.

(65) *Operations Audit Assignments.* A balance sheet audit, which includes operations, involves the examination of the borrower's records to verify the balances in all asset and liability accounts; to determine the accuracy and the adequacy of all revenue and expense accounts; to determine that all known transactions have been recorded on the books of the borrower; and to determine propriety of accounting procedures and practices. This type of assignment most closely resembles a balance sheet audit as conducted by a commercial public accounting firm. The fundamental principles involved in the conduct of a balance sheet audit are briefly stated as follows:

1. By test-checking certain selected transactions, the auditor establishes the extent to which detailed analyses of the records must be made.
2. By scanning the income accounts and comparing charges or credits throughout the audit period with the entries for the period test-checked, the auditor establishes the accuracy of the distribution of revenues and expenses. Unless there is a major deviation between the entries which were test-checked and the other entries, it is reasonably assumed that the income accounts are correct.
3. By verification of all balance sheet account balances as of the audit date and the scanning of income accounts mentioned in the preceding paragraph, the balance in the surplus, margins, or patronage capital account is verified.

4. The analyses of some balance sheet accounts such as consumers' accounts receivable, accrued expenses, reserves, and electric plant and work-in-progress accounts permit cross-reference to certain income and expense accounts and provide automatic verification of these accounts.
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- (66) An audit conducted according to these principles will meet the requirements of an acceptable audit from the commercial point of view. In order to pursue this examination it is very important that the auditor carefully study the essential features of the borrower's accounting procedure. It is often necessary to extend the scope of the audit beyond the limits ordinarily prescribed for a balance sheet audit. In addition to the normal requirements of a commercial balance sheet audit, a further analysis of transactions involving special funds, such as the REA Construction fund and the REA Installation fund, is desirable to properly discharge our responsibility to REA. It is also necessary to extend the scope of our examination of revenue and expense accounts in some instances, since an adequate system of internal control is difficult to achieve in the offices of the small borrowers.
 - (67) Whenever an inventory of assembly units constructed or purchased by the borrower is approved by the Rural Electrification Administration as a basis for distributing the costs involved to the appropriate plant accounts, such distribution will ordinarily be included as a part of the balance sheet audit assignment, and will constitute part of the work to be performed in connection with general audit assignments.
 - (68) If detailed examination is found to be necessary of transactions involving accounts which are not normally required to be examined in detail under the balance sheet audit procedure, the auditor should carefully analyze the situation prior to undertaking the review. Under ordinary circumstances, the special instructions on the assignment schedule will give detailed instructions regarding any special problems which are known to exist with reference to the borrower's records.
 - (69) If the balance sheet audit is assigned before the system has been energized, there will be some accounts which are not in use, such as revenue and expense accounts. Therefore, the audit plan outlined in succeeding pages will include certain items which cannot be followed in

such cases. However, it should be thoroughly understood that the general procedure outlined for the balance sheet audit should be closely adhered to in all instances in which it is applicable.

(70) The audit plan outlined in the following paragraphs generally describes the various major phases of the balance sheet audit. It is *not the intention of this audit plan to establish the sequence* in which the various steps outlined should be accomplished, since it is realized that every audit presents different conditions. All of the steps should be performed.

(71) *Audit Plan.*

1. Make a preliminary examination of the records to determine the status of accounts. The minute book should be examined to note special items which are pertinent to the audit, such as duly elected officers, persons authorized to sign bank checks and contracts, resolutions relating to the employment of personnel and basis of remuneration, and other related items.
2. Prepare the working trial balance.
3. Test the accuracy of accounting records in accordance with the test-check procedure.
4. Reconcile all bank accounts and prepare reconciliations of all cash funds, including detailed lists of all outstanding checks and deposits in transit, for all funds. Trace reconciling items shown outstanding in the prior audit into the bank. Confirm bank balances with the depositories by direct correspondence. Count petty cash and change funds. Reconcile cash receipts from audit closing date to the date of the cash count. Examine investment securities.
5. Make an adequate examination by budget purposes of transactions involving REA construction funds. Prepare a list of exceptions and apply to adjust borrower's reports. Prepare a debit-credit expenditure report if adjustments are necessary, which will be included in the audit working papers and be supported by your working papers detailing such necessary adjustments. The auditor's debit and credit expenditure report should be copied by the borrower for submission to REA in the usual manner.

6. Reconcile the trial balances of the notes receivable and accounts receivable subsidiary records with their respective control accounts. Verify the general ledger balance and obtain schedules of delinquent accounts and notes, showing the age of the various accounts. Examine notes held by the borrower or by the borrower's attorney, as agent for REA, to determine adequacy of collateral for Section 5 loans. See that each note is properly endorsed. Confirm delinquent accounts and notes receivable balances in accordance with REA procedures. Determine the adequacy of the reserves for uncollectible accounts and notes receivable. Reconcile the control account for advance payments with the subsidiary ledgers. Review transactions in this account and prepare schedule if necessary.
7. Examine the records supporting work orders, in accordance with test procedures, and check distribution to the electric plant accounts, if the bookkeeper has made distribution. If distribution has not been made, the auditor should request the bookkeeper to prepare a schedule and distribute all approved construction work orders and all retirement work orders during the audit. Verify the balance remaining in the construction work in progress account and identify with specific work order cost sheets. Verify balance remaining in the unclassified electric plant in service account and identify with prepared work orders or inventories which have not been approved by the Rural Electrification Administration. Verify the balance in the retirement work in progress account and determine that it actually represents work in progress.
8. Examine other construction work in progress accounts and prepare the necessary summaries or analyses. If REA has approved an inventory of assembly units installed in the system by a contractor or by force account, this inventory should be distributed, together with the related overhead construction costs. Before making this distribution, examine all contracts relating to the work completed so that compliance with the terms of payment can be verified. Examine the approved inventories and prepare a schedule,

showing the amount applicable to each utility plant account affected, to which should be added the pro rata amount of the applicable construction overhead costs. They should also be summarized on this schedule and should be stated in percentage of total direct costs. When the total amount and the distribution has been determined, prepare the audit journal entry and post to working papers.

9. Analyze and prepare a schedule on electric plant purchased or sold. If REA has approved an inventory of plant purchased, this should be distributed to the plant accounts. The auditor should set up in the proper account the acquisition adjustment, which is determined as the difference between (a) the amount paid by the organization for electric plant purchased, including acquisition costs, and (b) the original cost of the plant less estimated depreciation thereon to the date of the acquisition. The determination of the amortization rate should be referred to REA.
10. Analyze any plant accounts reflecting a change during the audit period and prepare working papers for the audit report. These should be tied into the work in progress accounts analyses or schedule of unclassified plant in service whenever possible to avoid duplication of effort.
11. When required, prepare an exhibit showing the accounts and amounts comprising the utility plant as of the beginning of the audit period, any changes during the period, and the balance as of the closing date of the period.
12. Obtain a detailed physical inventory of materials, both line and resale, from the borrower. Test-check quantities, unit prices and extensions, giving special attention to items having large dollar amounts in the inventory. Prepare analysis of the materials and supplies account, if necessary.
13. Examine all insurance policies and prepare necessary schedules. Determine propriety of amounts written off during the period under

audit and the distribution of such charges by accounts.

14. Verify all other asset and deferred charge accounts and prepare schedules necessary.
15. Prepare or check borrower's depreciation schedules for utility plant and analyze depreciation reserve accounts. The general plant property records should be checked with the respective control accounts. Secure inventory of tools and work equipment from the borrower. Test accounting procedure followed by the borrower with respect to additions and retirements of general plant property.
16. Verify membership records. Test procedure in accepting applications and issuing membership certificates with minutes of the board of directors' meetings to determine that the provisions of the by-laws are being complied with. Test-check membership certificates outstanding and compare with appropriate general ledger control account. Test-check membership subscriptions with membership subscribed account. Prepare reconciliation schedules when required.
17. Reconcile the subsidiary records for consumers' deposits with the appropriate general ledger control. Prepare necessary schedules.
18. Review REA construction and installation obligation transactions and reconcile with REA's billing statements.
19. Obtain a list, in the form of a trial balance of the subsidiary records, of members and others who made contributions in aid of construction. Determine propriety of balance in account. Reconcile subsidiary records for contributions and donations in aid of construction with general ledger control accounts. Verify consumers' advances for construction. Prepare necessary schedules.
20. Verify all other liability accounts, current, accrued and deferred. Prepare necessary schedules.

21. Analyze and test-check all members' and others' equity accounts, and reconcile subsidiary records.
22. Obtain from the manager a certificate to the effect that all liabilities are reflected on the books and no others are known to him.
23. Prepare audit journal entries and summarize when necessary. Post audit journal entry summary to working trial balance. Complete working trial balance and check all schedules with the completed working trial balance to determine that balances of the accounts are in agreement.
24. Determine that adjusting journal entries have been entered and posted to the borrower's records.
25. Prepare the balance sheet, related statements and schedules and comments.

(72) *Audit Report Requirements:*

1. Financial statements with comments thereon.
2. Auditor's general audit comments.
3. Field Activities Report (Form ADM-36).
4. Audit table of contents.
5. Audit assignment schedule.
6. Breakdown of time consumed in various tasks.
7. Working trial balance and other working papers supporting the audit adjustments and conclusions.
8. Exhibits as detailed in the standard audit working papers in Part V of this handbook.
9. Schedules or analyses of all accounts appearing on the balance sheet and other supporting working papers. The information required to be shown on the individual exhibits and schedules is indicated in Part V of this handbook.

(73) *Detailed Audits.* The detailed audit assignment involves verification of all accounting transactions and account balances. This generally includes an examination of all receipts and disbursements, to determine the propriety of all charges and credits made during the audit period, scrutiny of all journal entries and verification of posting of the journals to the general ledger. The difference between this audit and the balance sheet audit is the method and the extent of verification of accounts. The balance sheet audit procedure provides for examination by testing and sampling the entries in the records. The detailed audit procedure necessitates a detailed examination of all transactions within the period covered by the audit. Although detailed examinations of certain accounts may be made in connection with a balance sheet audit, such a partial detailed examination does not constitute a detailed audit. The assignment schedule will give the auditor any special instructions regarding the detailed audit to be conducted.

(74) It is necessary to perform a detailed audit when records have not been properly maintained so as to reflect the true financial condition of the borrower. In some instances, when misappropriation of funds and property is suspected, the detailed audit will be performed to establish extent of loss and to substantiate claims with bonding companies. The assignment of a detailed audit does not necessarily imply that a defalcation exists. In many cases, a detailed audit is the most expeditious method of adjusting borrower's records which have not been properly maintained.

(75) *Audit Plan.*

1. The plan for conducting a balance sheet audit should be followed in conducting a detailed audit with the exception of verifying accounts by the test method. The examination procedure in a detailed audit provides for an examination, in detail, of all transactions within the audit period.
2. In conducting the detailed examination required in this type of audit, the basic accounting records supporting original entries in the journal and the cash registers must be examined. Propriety of distribution of debits and credits arising from these transactions must be determined. Verify footings, cross-footings and

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postings to the general ledger. Prepare schedules supporting the adjustments necessary to correctly reflect the transactions reviewed.

3. Check files and loose papers for accounting data which have not been entered on the books. In order to determine that all transactions have been recorded, it may be necessary to review the appropriate correspondence files for information regarding unrecorded transactions.

(76) *Audit Report Requirements.*

1. Financial statements with comments thereon.
2. Auditor's general audit comments.
3. Field Activities Report (Form ADM-36).
4. Audit table of contents.
5. Audit assignment schedule.
6. Breakdown of time consumed in various tasks.
7. Working trial balance and other working papers supporting the audit adjustments and conclusions.
8. Exhibits as detailed in the standard working papers in Part V of this handbook.
9. Schedules or analyses of all accounts appearing on the balance sheet and other supporting working papers. The information required to be shown on the individual exhibits and schedules is indicated in Part V of this handbook.

- (77) *Construction Audits.* It may be necessary for an auditor to visit the office of the borrower in order to make a partial audit of the borrower's books and records. An audit having for its principal purpose the review and verification of the entries on the borrower's records of the transactions affecting the REA construction funds and to determine, in general, the propriety of accounting procedures and practices, is known as a construction audit assignment. The principles involved in the conduct of such an audit may be briefly stated as follows:

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1. Accounting for all REA construction fund receipts and disbursements.
2. Determination of the propriety of the disbursements and verification of supporting accounting evidences.
3. Determination of proper accounting disposition both as to budget classifications and ledger account postings.
4. Verification of charges and credits to construction and retirement work in progress and to plant accounts.
5. Review of accounting procedures and practices.

This type audit is assigned when the audit time is limited and it has been determined that a complete balance sheet or detailed audit need not or could not be made at that time.

(78) *Audit Plan.*

1. Prepare a working trial balance.
2. Verify REA construction loan fund cash account as stated in paragraphs 150 through 159 of this manual.
3. Examine records supporting construction work orders and retirement work orders in accordance with the test-check procedure and check the distribution to the electric plant accounts.
4. Verify and identify the balance remaining in the work in progress accounts and in the unclassified electric plant in service account.
5. Analyze all the plant accounts which reflected a change during the audit period.
6. Check borrower's depreciation schedules for all utility plant accounts and analyze depreciation reserve accounts.
7. Review, in general, all controlling accounts maintained in the general ledger and ascertain whether trial balances of the subsidiary ledgers or records are maintained.

8. Review, in general, the method of bookkeeping and ascertain whether the procedures are in accordance with those recommended by REA.

(79) *Audit Report Requirements.*

1. Working trial balance and other working papers supporting the audit adjustments and conclusions.
2. Auditor's general comments.
3. Field Activities Report (Form ADM-36).
4. Audit table of contents.
5. Audit assignment schedule.
6. Breakdown of time consumed in various tasks.
7. Exhibits and schedules or analyses to present adequately the work performed. The specific information required will be found in Part V of this handbook dealing with standard audit working papers.

- (80) *Construction Audit Following General Audit by CPA.* The construction audit described in paragraphs 77, 78 and 79 should be modified to eliminate any unnecessary duplication of work already performed by the CPA. The CPA audit will be followed promptly with a construction audit by an REA auditor. The period covered should be from the "as of" date of the last audit by an REA auditor to the "as of" date of the CPA audit. A copy of the CPA audit report will be furnished the REA auditor with the construction audit assignment. Since the "as of" dates will be the same, a detailed reconciliation of the bank account will not be necessary as this was included in the CPA audit.

(81) *Audit Plan.*

1. Check the closing construction cash balance in the CPA audit with the cash balance on the books of the borrower as of that date.
2. Verify REA construction loan fund cash account as stated in Paragraphs 150 through 159 of this handbook, except that the accounting distribution needs only a cursory review.

3. Make a limited review of accounting procedures and practices and the method of bookkeeping and ascertain whether they are in accordance with those recommended by REA.
4. Prepare an Adjusted Expenditure Report in accordance with instructions in the handbook.
5. Have borrower submit executed copies of the Adjusted Expenditure Report to REA.

(82) *Audit Report Requirements.*

1. A summary of REA special construction fund as of audit date with comments thereon.
2. Auditor's general comments.
3. Field Activities Report (ADM-36).
4. List of audit journal entries prepared by CPA.
5. Statement as to the number of days consumed by the CPA and the cost of the audit.

(83) *Special Audits.* In some instances audits will be assigned which require examination of specific accounts or parts of the borrower's records, and will not be made in conjunction with a general audit assignment. Ordinarily the audit assignment schedule will give detailed instructions and information on the work to be performed. The most common special audit is the audit of contractors' and engineers' payments. This special audit will be briefly described as a separate topic under this section.

(84) *Audit Plan.* Since audits of this type involve special problems, no general audit plan can be presented for the guidance of the auditor. The instructions on the assignment schedule will provide the auditor with the purpose of the audit and the information requested. In conducting a special audit, the auditor should closely adhere to the instructions given and include all the information requested in his report.

(85) *Audit Report Requirements.* The audit report shall include comments, exhibits, and schedules to present adequately the information requested on the audit assignment schedule.

Special Audit of Contractors' and Engineers' Payments.
The audit of contractors' and engineers' payments covers an examination of the advances made for, and payments made to contractors and engineers for construction contracts for a specific section of a system. The purpose of this audit is to determine the accuracy of the borrower's records as to amounts advanced by the Rural Electrification Administration for contractors and engineers, as well as the total payments made by the borrower to each and the balance available for each purpose, as of the date of the audit. Since one of the purposes of the audit is to expedite payments to contractors and engineers, the report required should be promptly prepared and submitted. It is generally recognized that this special audit is not time consuming, yet the auditor should be fully aware of the importance of this type of audit report.

(87) *Audit Plan.*

1. Examine the construction contract and engineering contract, if any, in order to determine the terms of payment and conditions governing payments to each contractor.
2. Verify the disbursements made by the borrower to each contractor. Determine that such disbursements apply to the specific contracts involved.
3. Obtain receipted invoices covering the payments to the contractor, engineer, etc., and compare the total amount paid with each check covering such payment. In some cases, payments may have been made to the contractor or engineer from funds other than the REA construction fund, so the auditor must always be aware of this possibility when conducting his examination. The auditor should also include the pertinent details of all transactions in which material has been furnished to the contractor by the borrower. This information should include amounts involved, method of payment and borrower's accounting treatment.
4. Prepare a schedule of advances for the contractor and engineer, also record payments made to each.

5. Reconcile total advances for these particular budget purposes, for the section and contracts involved, with the latest approved Financial Requirement Statement.

(88) *Audit Report Requirements.*

1. Field Activities Report (Form ADM-36).
2. Audit table of contents.
3. Audit assignment schedule.
4. Auditor's comments, if it is necessary to give further information on unusual conditions with reference to the assignment.
5. Schedule of advances and payments to the contractor and engineer, and balance available for each as of the audit date. This schedule should be designated as to contracts and sections of the system involved.

(89) *Special Report Assignments.* Assignments which do not involve the normal functions of auditing are termed special reports. Advising bookkeepers and reporting on the condition of the borrowers' records, developing construction and retirement work order cost data, assisting in preparation of reports to regulatory bodies, and acquisition closing are the most frequently assigned. The purpose of the report, scope of assignment and special problems involved will, in each case, be outlined on the audit assignment schedule.

(90) In addition to special reports, which are assigned on a schedule, the auditor, in some instances, will be required to submit special reports in connection with an assigned audit. When the auditor finds the borrowers' records in a condition which makes an audit impossible until the records are brought to a satisfactory status, a report should be made to the supervisor immediately. All the facts should be presented with an accurate estimate of the time required to bring the books up to a satisfactory condition to be audited. Another instance in which a special report is required, but not assigned on a schedule, is when an auditor discovers a misappropriation of a borrower's assets. Such a special report is fully explained in the latter part of this section.

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- (91) *Report Plan.* The purpose and scope of each report will vary so widely that it is impossible to give a general plan to embrace all special reports. A brief summary of major points to be covered for each of the most frequently assigned special reports is given in the following paragraphs:
- (92) *Advising Bookkeepers and Reporting on the Condition of the Borrowers' Records.* This special report involves the review of the borrower's books and records with the object of rendering advice to recently employed bookkeepers or to bookkeepers who are found inadequate in the performance of their duties. The auditor performs his work at the borrower's office at all times, and assists the bookkeeper, when found necessary, in preparation of reports and other data. A review of the REA Manual of Accounts and accounting procedure with the bookkeeper will generally be necessary. The written report to be submitted by the auditor should present pertinent information on the qualifications of the bookkeeper, the auditor's opinion of the ability of the bookkeeper and the general conditions of the records. The report should also include a summary of the work performed by the auditor in completing the assignment.
- (93) *Developing Construction and Retirement Work Order Cost Data.* In some instances, an auditor may be assigned to develop construction cost data for the use of other REA field personnel in bringing work orders to an acceptable status. Such an assignment is performed only on the basis of specific instructions. The need for this work arises when assistance is required for accurate compilation of construction costs and is not undertaken for the purpose of performing the borrower's work. In this assignment the auditor is chiefly concerned with establishing correct costs to be applied to the construction assembly units as established by other REA divisions in field inventories. The report submitted should include the detail of the work performed by the auditor, and working papers prepared supporting the auditor's conclusions. The extent of his collaboration, as well as the remedies taken and procedures recommended for prevention of similar difficulties, is pertinent information to be reported.
- (94) *Assisting in Preparation of Reports to Regulatory Bodies.* Many states require reports from the borrowers at periodic intervals. Federal Agencies, such as the Federal Power Commission, also require special reports

from certain classes of borrowers. In some cases it is necessary to assist the borrower in preparation of accurate reports. Specific instructions will be given to the auditor on the assignment schedule. The auditor's special report will contain comments regarding the work performed, copies of reports prepared, as well as supporting exhibits and schedules.

- (95) *Acquisition Closing.* The acquisition closing report is required when a borrower acquires utility property by purchase. The acquisition closing is completed in cooperation with representatives of the Office of the Solicitor, and in certain instances, representatives of other divisions. The purchase agreement sets forth the base purchase price and items subject to adjustment which may raise or lower the price actually paid for the property. The auditor should examine the purchase agreement in order to be able to verify the adjustments. The most common items subject to adjustment are materials and supplies, which are subject to physical inventory; accounts receivable and consumers' deposits, which are subject to audit verification; taxes, insurance and current energy billings, which are sometimes prorated; and plant additions and retirements, which are subject to verification. It is necessary for the auditor to verify all adjustments in this type of assignment. In connection with an acquisition closing, the auditor should ascertain the completeness of the seller's records in order to determine the historical cost of the acquired property, or, if the records are inadequate, to advise, in the report that an appraisal, based on a physical inventory of the acquired property, is needed.
- (96) The special report to be submitted should include comments giving the details of the date of closing, place of meetings attended and persons attending, subject matter discussed, and recommendations. Schedules supporting the adjustments should also be submitted, such as copies of purchase agreement, adjustment schedules, detailed inventories of materials and supplies, schedules of accounts receivable, consumer's deposits, refundable advances for construction, prorating of current billings, and similar items.
- (97) *Reporting on Unsatisfactory Records.* Although the field supervisor is expected to make a preliminary review of the records of the borrower prior to assignment of an audit, the borrower may not have completed the

work required to bring the records into proper condition before the auditor arrives. When the auditor finds the records in a condition which makes it impossible to conduct an audit, he should immediately make a special report of the situation.

- (98) The special report should cover, in detail, the book-keeping work which must be completed before the audit assignment can be started. To render such a report, it is necessary that the auditor carefully analyze the situation. An estimate of the time required to bring the books to a current status should also be given. *Under no circumstances should the auditor proceed to do the bookkeeping without specific instructions.* The report should also give a summary of the preliminary work of the auditor and the advice given to the borrower's personnel for bringing the books to a current status.
- (99) *Defalcations.* During the conduct of a general audit or detailed audit, the auditor may find transactions which appear to be misappropriations of the borrower's assets. This will most likely be discovered in the test of cash receipts and disbursements, but can appear in any number of accounts which are affected by cash. The auditor should always be alert to any indication of defalcations.
- (100) If the auditor finds transactions which lead him to suspect a defalcation exists, he should immediately trace these transactions. The fact of whether or not a defalcation exists should be definitely established immediately, to the exclusion of all other phases of the audit. During the course of the investigation of a suspected defalcation, the auditor must be extremely careful not to disclose his suspicions to any member of the borrower's staff. After he has definitely established, beyond a reasonable doubt, that funds or property have been misappropriated, he should promptly report this fact to his field supervisor and the National office. Immediately following this notification, the auditor should prepare a detailed report, giving all the facts and proof of the defalcation. The auditor should then continue his examination until the field supervisor arrives or further orders are received from the Washington office. He should not communicate his discovery or the facts on which he bases his conclusions to any of the personnel of the borrower until he has been given authority to do so by the field supervisor or the Washington office, at which time he will be advised of the appropriate action to take.



PART III
AUDIT PROCEDURE

MINIMUM ACCEPTABLE AUDIT

- (101) This handbook has been prepared as a guide for new REA auditors and as a reference book for experienced REA auditors. It provides a general working plan for each type of audit required as well as instructions for the auditor in conducting his work. *It prescribes what REA considers a minimum acceptable audit.*
- (102) The handbook must be interpreted and applied to each specific audit in the light of circumstances and problems existing at the time of the audit. If it is not practicable for the auditor to meet the established standards in a particular audit, he should modify the procedure to meet the exigency. He may deviate from the standards set if the borrower's records will not permit following the prescribed procedure within a reasonable time limit; or other conditions indicate that complete compliance is not necessary to assure a good audit. *Such exceptions must be justified either in the Field Activities Report or by appropriate notation and explanation on the schedule affected.*
- (103) Freedom to exercise individual professional judgment in the handling of certain audit problems is necessary in order to enable an auditor to perform his work in an efficient manner. The REA audit staff is made up of individuals who have been specially trained, in a uniform manner, to follow prescribed accounting principles and procedures as they apply to REA borrowers. Some individuals may be inclined to minimize the need of carrying out the work to the required extent, in an effort to save time, or may succumb to the thought that it will not make any material difference. This must be avoided. It must be emphasized that any audit, which has been processed and finally approved, becomes a chapter in the financial history of the borrower. It should not, at any time, be necessary to deviate from such audit findings, except for most unusual reasons. Each audit must be capable of standing the acid test in the most severe scrutiny in any court action.

CONSIDERATIONS IN BEGINNING AN AUDIT

- (104) *Planning the Audit Program.* The expeditious completion of an audit assignment is dependent on a well-planned

program for conducting the work. Time spent in planning the audit program is never wasted time and will result in a complete, well-balanced audit performed in a minimum amount of time. It is far more efficient to study the records of a borrower at the outset of the audit and develop a well-balanced program than to rush in and "get to work." Countless hours are likely to be spent on unnecessary tasks, when an effective program is not planned, to the exclusion of some very important phases of an audit.

- (105) When assisted by other auditors, the auditor in charge should avoid permitting the assistants to be inactive during the early stages when the audit program is being formulated. This can be accomplished by making assignments to the assistants on the first day. Items on which the assistants can begin working include preparation of disbursement schedules, development of work order analyses, counting cash, reconciliation of the receivable accounts, and other reconciliations and analyses of accounts.
- (106) In planning the audit program, the first step is to become thoroughly familiar with all the books used by a borrower. It is true that all borrowers use the same accounting system and keep similar records. It is very important, however, that the auditor become familiar with the office procedures and routines in keeping these records, and the extent to which the borrower uses the records. This knowledge will serve as a guide to the auditor in determining the adherence by the borrower to the recommended accounting procedures, as well as save time in tracing transactions through the books.
- (107) After becoming familiar with the records and the extent to which they are used, the auditor should study the office routine. The duties and responsibilities of each member of the borrower's staff should be clearly defined to the auditor. The routine handling of daily transactions should be studied to determine the adequacy of internal control. This will give the auditor the basic facts of the recording operation as it is carried on in the borrower's office, and will assist him in determining the extent to which it will be necessary to perform detailed checking of individual transactions.
- (108) When these facts regarding the borrower's records and accounting procedures are known to the auditor, he should study the list of accounts as shown on the trial

balance. These factors make it possible for the auditor then to plan his program for conducting the audit.

- (109) *Review of By-Laws.* The majority of borrowers of the Rural Electrification Administration are cooperative enterprises, organized as nonprofit corporations or associations under the laws of their respective states. The charter granted by the State gives the borrower the right to transact business in that State as a corporate entity. This charter is granted on the basis of certain documents which have been filed with the State and which set forth the nature of the organization, the type and character of the operation or business to be conducted, the purpose of the organization, the period of existence, and so on. These documents are generally known as the articles of incorporation and the corporation by-laws.
- (110) Since the borrowers must conform to the corporation laws of the State in which they are organized and to the articles of incorporation and the by-laws of their own organizations, the auditor should be generally familiar with the corporation laws of the States in which he is assigned. He should also be familiar with the by-laws of the borrower cooperative since these rules govern the accounting for business transactions.
- (111) *Examination of Minute Book.* During the early part of the audit, the auditor should arrange to obtain from the borrower's personnel the minute book of the board of directors of the cooperative. These minutes should be reviewed by the auditor to note any resolutions which affect the conduct of his audit. He will gain an overall picture of the various problems confronting the borrower with reference to the maintenance of accounting records. It might be helpful if the auditor made notes of the various rules and regulations, salaries, and items such as contracts, agreements, and similar matters, which have been properly or improperly approved by the board of directors. He should determine which persons are authorized to sign checks and agreements from his review of the minutes.
- (112) *Review of Field Files and Previous Audit Reports.* The auditor will be furnished with a field file on the borrower, containing previous audit comments of all types and copies of letters directed to the borrower by REA. He will also have available prior audit reports which should be reviewed to provide a background for his present audit. The beginning figures in the current

audit should tie in with the totals reflected in the preceding audit report.

- (113) The auditor should bear in mind that his review of prior reports is made for the purpose of familiarizing himself with the general background of the borrower's records, and not for the purpose of analyzing and examining the audit report. If any instance arises in which it is considered necessary to reexamine transactions covered in a previous audit period for the purpose of correction, authority must first be obtained from the Washington office before undertaking such re-examination.
- (114) *Becoming Familiar With Borrower's Filing System.* It will facilitate the work of the auditor if arrangements are made to have the borrower's management explain the details of the filing system. At this time arrangements can be made to permit the auditor normal freedom in using all records as the occasion requires.
- (115) *Examination of Contracts and Agreements Relating to the Accounting Records.* The auditor's understanding of the needs of the particular audit will be increased by a preliminary examination of any contracts or other agreements which have a bearing on the assets and liabilities of the borrower.
- (116) *Determination of Work Required of the Bookkeeper.* As soon as the auditor has prepared his work schedule for the conduct of the audit, it should be possible for him to have a conference with the manager and the bookkeeper, outlining certain work which will be necessary for the borrower's employees to complete, prepare, or perform during the course of this audit, in order that the data necessary will be ready at the time the auditor requests it.
- (117) The following is a suggested list of items which the borrower's employees should make available to the auditor:
 - 1. Inventory Certificate with supporting Inventory of Materials.
 - 2. Depreciation register.
 - 3. Schedule of prepaid insurance.

4. Trial balance of accounts and notes receivable.
5. Bank statements and cancelled checks.
6. Paid and unpaid vouchers brought to current status for auditor in proper order.
7. Schedule of general plant property.
8. Completed work orders covering construction and retirements.
9. Detailed schedule of reimbursement checks.
10. Trial balance or tape of consumers' deposit ledgers.
11. List of contributions in aid of construction.
12. File of REA Statements of Interest and/or Principal.
13. List of unreported REA construction fund expenditures.
14. Copies of requisition and expenditure reports.
15. Analyses of Work-in-Progress accounts.

(118) *Adequacy of Internal Control.* Reference is made throughout this handbook to "adequacy of internal control." It is important that the auditor realize the significance of this term since it appreciably affects his work.

(119) Internal control can be described as the performance of internal audit through the arrangement of office routine and individual employee's duties. It is the arrangement of office routine wherein the result of the work of one employee is complementary to the result of the work of another employee. In some cases, the duties of one employee are contingent upon the performance of a certain phase of the work by another employee. Sometimes it requires that joint action be taken by two or more employees. Whatever the form or combination of forms used to accomplish internal control, an effective system of internal check, constantly exercised through the regular office routine, reduces errors to a minimum and greatly

reduces the opportunity to defraud without fear of detection.

- (120) The auditor can readily see that proper functioning of an effective system of internal control will greatly reduce the extent of checking of original records for individual transactions. *However, to determine that a system of internal control is in operation is not sufficient. The auditor must check the results of its operation. This is accomplished by application of the test-check procedure which is explained later in this handbook.*
- (121) *Auditing Methods Applied in This Procedure.* There are two fundamental methods used in verifying accounting records. One method starts with the original records and traces each transaction through to the general ledger and the working trial balance. The other method starts with the general ledger balance and analyzes the individual entries appearing in the account. While both methods provide a detailed verification of all transactions, neither is satisfactory to be used in its entirety for the purpose of conducting a general audit.
- (122) The general audit procedure provides for a combination of the basic methods, thereby eliminating some of the disadvantages of both methods. Neither of the methods is followed to completion; that is, a part of the records is checked with one method and part the other. The method whereby the auditor starts with the original records is used for the purpose of testing the accuracy and the adequacy of accounting records and procedures; and the method of checking entries from the ledger accounts is used to analyze certain balance sheet accounts and to pick out unusual items appearing in the revenue and expense accounts.
- (123) In presenting the subsequent sections of this part of the handbook, which explain in detail the procedure to be followed for testing accounting records and verifying balances of specific accounts, certain duplications of verifications appear to be required. *The efficient auditor will find that certain phases of verifications of several accounts can be performed in conjunction with the verification of one account. It is neither the thought nor intention of this handbook that such short cuts should be overlooked; in fact, it is emphasized that all duplication of work be avoided. However, to insure that all the important points and*

phases of verifications for specific accounts are treated, this handbook reiterates procedures for verification under the titles of the various accounts affected. Therefore, the auditor should use his knowledge and skill in auditing procedure to eliminate all duplication of effort from the audit program for his individual assignment.

(124) TEST-CHECK PROCEDURE

The test-check procedure is based on the premise that errors or manipulated entries will occur consistently. This is illustrated by the "kiting" of receivables or cash where the records have to be manipulated constantly to cover misappropriations. Similarly, errors in account distribution of expenses or revenues are made more or less consistently in most cases since such errors are caused by misinterpretation of the system of accounts. By testing a representative number of transactions to determine the accuracy of the accounting treatment accorded these specific items, the auditor is able to evaluate the propriety of all the transactions recorded in the books during the period being audited. This testing procedure together with analyses of certain balance sheet accounts will provide the necessary verification of the accounts for presentation in the financial statements.

- (125) There are some general rules to be followed in applying the test-check procedure. First, it is important that the test be conclusive. If, for instance, the auditor can not readily locate an invoice to support a disbursement, the particular invoice must be located or the disbursement be supported in some other manner satisfactorily. Second, when a review of a given percentage of like transactions reveals improper accounting treatment, the auditor should not consider the job done, *but must examine all transactions of this type in which the faulty treatment was discovered.* Third, the auditor should select the month or months to be tested in detail. The test period should not coincide with the period tested in the prior audit. This is to prevent the possibility of the borrower's employees knowing in advance the period which will be checked in detail. Finally, care should be exercised in performing detailed checks in order to insure the adequacy of the sampling process.

- (126) The length of the period for which transactions will be

tested in detail should be determined to meet the needs of the individual audit. Some of the factors to be taken into consideration in making this determination are (1) the adequacy of the internal control system (2) the condition of the records (3) the ability of the personnel and (4) the rate of personnel turnover. While the number of transactions within the audit period will affect the number of individual items tested, this factor should not affect the scope of the test-check procedure. Taking all the factors into consideration, the general standard is that one-twelfth to one-sixth of the original entries should be verified. For example, an audit covering a period of 18 months would involve the test-checking of transactions for one to three months. An audit of one year or less would involve the testing of transactions for one month. *However, in light of the conditions obtaining in each situation, the auditor should test-check a sufficient number of transactions within the audit period to satisfy himself as to the accuracy of the entries in the accounts.*

- (127) *Scope of the Test-Check Procedure.* The application of the test-check procedure requires (1) the examination of accounting evidence supporting original entries for the test period, that is, the period for which transactions are being tested in detail, (2) tracing such entries into the general ledger accounts and (3) tracing the individual items examined which support entries to the control accounts into the respective subsidiary records. As a result of the test-check, the transactions in many accounts may be reviewed by comparison of entries verified in this manner with other entries in the respective accounts to note unusual deviations requiring further verification. The scope of the test-check as it applies to the various books of original entry and related records is treated in the following paragraphs.
- (128) *Cash Received Records.* It is recognized that there will be considerable variation in detailed cash received records and, as a result of this, it may be necessary for the auditor to deviate from the procedure outlined. Any deviation should be justified by a suitable explanation in the audit working papers.

- (1) Trace the cashier's stubs and cash tickets into the daily cash collection sheets for certain days within the test period to determine ac-

curacy of amount and propriety of account distribution. The number of days within the test period to be checked in this manner will be determined by conditions existing in a particular situation. Transactions for entire days, selected at random, should be checked in detail and the number of transactions so checked should aggregate 20 percent of the total transactions within the test period selected.

2. Trace the cashier's stubs or cash tickets examined in detail for not less than one representative day into the respective subsidiary accounts, item by item, to determine accuracy of posting. Note that the dates on stubs are in agreement with those on the cash report and the subsidiary accounts.
3. After the entries on the daily cash collection sheets have been verified for the days being tested in detail within the period, verify the footings of the sheets for these particular days and trace totals into the cash received record.
4. Scan the entries in the cash received record for the test period and verify the propriety of any unusual items if such entries were not previously verified in the detailed check of certain days.
5. Verify the footings and crossfootings of the cash received records for one-half the total period under audit. Include the test period in this verification.
6. Trace the totals of the account distribution columns of the cash received records for the test period into the general ledger accounts. Identify each entry which has been verified by this procedure so that other entries in the account, not verified in this manner, can be compared for unusual deviations.
7. Reconcile the deposits with receipts for the months in the test-check period.
8. Determine that deposits in transit as of the date of the audit were actually deposited in the bank on the proper day. Examination of dupli-

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cate deposit slips or subsequent bank statement will supply this information.

(129) This test-check of cash received records will provide the basis for verification of:

1. Credits to notes receivable arising from cash receipts.
2. Credits to accounts receivable arising from cash receipts.
3. Credits to materials and supplies arising from cash sales.
4. Credits arising from consumer deposit collections.
5. Credits to consumers' advance payments arising from cash receipts.
6. Contributions in aid of construction arising from cash receipts.
7. Credits arising from cash receipts of membership fees.
8. Revenues arising from sources other than energy sales.

(130) *Cash Disbursement Records.*

1. Examine for authenticity the invoices or other accounting evidence supporting each disbursement made during the test period with the exception of payroll disbursements which will be verified separately.
2. Trace charges originating from cash disbursements for the test period into the respective subsidiary records.
3. Verify the footings and crossfootings of the cash disbursement records for one-half the total period under audit. Include the test period in this verification.
4. Trace the totals of the account distribution columns of the cash disbursement records for the test period into the general ledger accounts.

Identify each entry which has been verified by this procedure so that other entries in the same account, not verified in this manner, can be compared for unusual deviations.

5. Reconcile the disbursements with bank charges for the months in the test-check period.
6. Examine the cancelled checks returned by the bank for disbursements made during the test period and compare, item by item, with entries in the cash disbursement record as to payee, date and amount.
7. Examine all checks paid by the bank during the test-check period for proper endorsements and authorized signatures. In cases where banks fail to require endorsements, the auditor should take this matter up with the manager and request that he contact the bank for the purpose of advising it to refuse payment where endorsements have not been properly made. Where banks have not required signature cards for signatures or endorsements on checks, the auditor should recommend that this procedure be conformed immediately. The auditor should verify that provision is made in the minutes for designation of certain individuals to sign checks, and what restrictions are placed on use of accounts. Any departure from the resolutions of the board should be reported in the audit comments.
8. All checks drawn to cash, banks, officers or employees, except regular salary checks, should be examined and the propriety of such checks determined. Also investigate any checks drawn to other payees which are endorsed by employees.
9. Trace transactions by which the bank debited the account of the borrower for checks returned for insufficient funds or other reasons. Determine that such checks have been properly recorded on the records of the borrower, and have been re-deposited, collected in cash and redeposited, or held in the safe. If such checks are held in the safe, they should not be considered as part of the cash on hand or in transit to the bank.

10. Determine that all prenumbered checks drawn in the period of the test-check are accounted for, either by a cancelled check paid by the bank, an outstanding check, a voided check, or blank checks held by the borrower. Examine all voided checks to determine that they are all accounted for and are properly mutilated to prevent subsequent cashing.

(131) This test-check of transactions originating from cash disbursement records should be applied, where applicable to the accounts payable register when the borrower makes distribution of unpaid invoices through the accounts payable register at the end of the month. This test-check of cash disbursements (and payables, if any) will provide the basis for the verification of the following:

1. Distribution of charges arising from petty cash disbursements.
2. Debits to materials and supplies for purchases.
3. Posting of materials purchased to perpetual inventory records.
4. Debits to prepayments arising from disbursement.
5. Charges to deferred debits.
6. Debits to notes payable.
7. Debits to accounts payable.
8. Distribution of charges arising from accounts payable.
9. Debits to consumers' deposits for refunds.
10. Debits to the accrued accounts.
11. Debits for membership refunds.
12. Charges to all expense accounts arising from cash disbursements.

(132) *Payroll and Transportation Expense Records.*

1. Examine daily time sheets for the test period to determine accuracy of account distribution of

time and mileage; trace these daily time sheets into payroll summaries and into mileage summaries, foot hours and mileage recorded on individual employees summaries and individual transportation summaries.

2. Test accuracy of calculations on payrolls for the test period, including propriety of rates applied, extensions, taxes deducted or withheld, overtime calculations, individual earnings records, footings of payroll summaries, authorizations for deductions of withholding tax, etc.
3. Verify accuracy of determination of unit costs of mileage and distribution to accounts affected. The propriety of items included in such costs should be verified in connection with the test-check of original entries charging the transportation clearing account. Foot transportation summaries.
4. Trace charges for construction labor and mileage to the individual work order cost sheet or other cost records by work orders for the test period.
5. Trace payroll summaries for the test period into the cash disbursement records and verify propriety of distribution by checks. If payroll distribution is made by journal entry, also trace the summaries to the entry making the distribution.
6. Trace the mileage cost summary into the journal entry making distribution of the clearing account for the test period.
7. Trace the journal entries into the ledger accounts.

(133) This test-check will provide the basis for the verification of the following:

1. Propriety of charges to construction for direct labor, mileage, and overhead labor.
2. Propriety of charges and distribution to expense accounts for labor and mileage.
3. Compliance with existing labor laws with respect to minimum payments and payroll records.

4. Adequacy of payroll procedure from the point of view of internal check and establishment of a basis for proper time distribution.

(134) *Energy Billings and Adjustments*

1. Check new connections as indicated on work orders or other cost records, for one month, with the consumers' ledgers to determine that such consumers are actually being billed.
2. Test-check a sufficient number of billings within the test period to determine, to the auditor's satisfaction, that the proper rate schedule has been accurately applied in the billing computation.
3. Test-check a representative number of postings for energy billings shown in the individual consumers' accounts to reasonably establish the accuracy of such postings.
4. Test-check the journal entries to the revenue accounts which involve adjustments and corrections to accounts receivable and determine that such entries have the authorization and approval of some responsible person whose duties do not include handling cash receipts.
5. Determine whether amounts charged to the reserve for uncollectible accounts receivable during the test period have been properly authorized. Trace posting of these items to the individual consumer's ledger account. Determine the disposition of ledger sheets for individual accounts which have been written off.
6. Test-check a representative number of entries within the test period recording penalties and forfeited discounts.
7. Test-check credits to accounts receivable for the test period arising from application of membership fees, consumers' deposits or consumers' advance payments. These same items should be traced to the respective subsidiary records.
8. Where the consumers' records are maintained by

groups or routes and where an effective internal control exists, it is necessary to test-check only approximately 20 percent of the routes in the test-check period. All transactions in the test period affecting the groups selected should be examined.

9. Trace postings of journal entries which have been examined into the general ledger accounts.
10. Check the meter constants on a selected number of large power industrial and commercial consumers to determine the accuracy of the computation of kilowatt hours of electricity used.
11. Investigate the procedure for billing disconnected or final accounts as well as the disconnect policy in force to determine whether such procedure is followed in accordance with board policy.

(135) *Material and Supplies.*

1. Examine purchase orders, receiving slips, and approved invoices in support of disbursements for materials and supplies purchased.
2. Trace material requisitions issued during the test period into the summary of materials used and verify propriety of account distribution.
3. Test-check accuracy of unit price calculations, extensions and totals of a representative number of purchases and requisitions and trace posting of these items to the perpetual stock records through the summary of materials used. Check a representative number of stock cards in the perpetual stock record for consistency of unit prices. Any relatively large variation should be investigated.
4. Trace charges for construction material used to the individual work order cost sheet or other cost record for the period of test-check. Emphasis should be placed on the complete tie-in of the basic cost records, such as materials costs, with the completed work order.
5. Examine in detail the records supporting other

credits to the materials control account for the test period.

6. Trace credit requisitions issued during the test period for materials returned to stores or salvaged from retirements, to retirement work orders, to the deduction on summaries of materials used, to the perpetual stock record, and to the journal entries distributing the charges to the control account.
7. Verify propriety of accounting distribution of other charges and credits on the daily records and trace into summaries and into the general ledger accounts.

(136) *Insurance and Taxes.*

1. Verify the accuracy of amounts charged to insurance for expirations of prepaid premiums within the test period. When such expirations are based on payrolls, verify propriety of rates, extensions and account distribution.
2. Verify the accounting distribution for expired insurance premiums which have been charged out during the period of the test-check.
3. Verify accuracy of charges for taxes, for the test period, which are not based on payrolls. This can be accomplished by tie-in of the accrual analysis.
4. Verify accuracy of computation of taxes based on payrolls for the test period and propriety of account distribution.

(137) *Depreciation.*

1. Verify accuracy of depreciation charges for the test period for production, transmission and distribution plant.
2. Examine borrower's schedules of general plant property, subject to depreciation, and verify charges to depreciation for general plant during the test period.

(138) *Work Order Inventory Distribution.*

1. Verify allocation of overhead charges to the individual work orders for the test period.
2. Verify propriety of capitalization of meter and transformer installation costs.
3. Verify propriety of account distribution of assembly units and trace totals of inventories into the journal entries.

(139) *Other Journal Entries.*

1. Review all other journal entries for the test period and examine the accounting evidence supporting such entries. Trace journal entries for this period into the general ledger accounts.

(140) This test-check of journal entries will provide the basis for the verification of the following:

1. Revenues arising from billings for electric energy.
2. Revenues arising from penalties and forfeited discounts.
3. Adjustments for corrections to billings.
4. Adjustments to accounts receivable for application of membership fees, consumers' advance payments and consumers' deposits.
5. Credits to materials and supplies for stores issues.
6. Charges to construction for materials used.
7. Credits for materials returned to stores or salvaged.
8. Credits to retirement work for materials salvaged.
9. Expenses arising from materials used.
10. Expirations of prepayments for insurance.

11. Tax accruals.
12. Distribution of construction and retirement work orders.
13. Amortization of deferred charges or credits.

CASH

- (141) The audit procedure for verification of the cash accounts is perhaps the most detailed of any of the verification procedures. This is necessary because the volume of cash transactions is larger than any other type of transaction, and cash, as such, is more often misappropriated than any other asset. A second important reason for the extended scope of the examination of cash accounts and cash transactions is to determine the propriety of expenditures of Government loan funds.
- (142) The audit procedure outlined in this section generally applies to all cash accounts. In some instances, special procedures are required for certain cash accounts and these are specifically mentioned as applying to the particular accounts affected. An example is the additional verification necessary for all loan fund disbursements. In addition to loan funds, certain other cash funds are subject to restrictions as to the purposes for which these funds can be used. The auditor should become thoroughly familiar with the purposes and requirements of each cash account. All restrictions should be carefully noted to determine that such funds are not disbursed in violation of the restrictions.
- (143) An effective system of internal control will provide the safest check on propriety of accounting for all cash transactions. The auditor should carefully study the methods by which daily transactions are recorded in the office of the borrower to determine that all possible safeguards are utilized in the internal control system. To assure maximum protection to the borrower, the internal control system should provide:
 1. The responsibility for opening mail and for receiving cash should be delegated to different individuals.
 2. The responsibility for posting cash credits to

the individual consumer's account ledger and for receiving cash should be delegated to different individuals.

3. The individual acting as cashier should not have access to the general ledgers of the borrower.
4. The change fund provided for the use of the cashier should be in an amount large enough to carry on normal daily business transactions, and should be reconciled daily at the time the bank deposit is prepared.
5. Cash receipts should be deposited in the bank intact, preferably daily.
6. Bank statements should be carefully checked each month and should be reconciled with the book accounts by a different individual from the one responsible for making deposits and drawing checks.
7. All checks should be prenumbered and all numbers should be accounted for when the bank statements are reconciled.
8. When an error is made on a check when it is being drawn, the check should be mutilated to indicate it is voided and the voided check should be carefully preserved.
9. All checks should be countersigned and the procedure must provide that original invoices or other accounting evidence be presented to the official countersigning together with the check to be signed.
10. Checks must never be signed in blank by either the signer or the countersigner.
11. All invoices should be marked with a conspicuous stamp when paid so that the same invoice cannot be presented for payment again.
12. The person responsible for approval of invoices or statements for payment should not be the same person responsible for entering such payments in the general ledger records.

13. Petty cash should be handled on the imprest fund system, and one employee should be made responsible for this fund.
 14. All reimbursements to the petty cash fund, which should be made at the close of each month and at such times as may be necessary, must be supported by properly executed receipts. Such reimbursement checks should be drawn to the individual who is responsible for the petty cash fund and should bear his endorsement.
 15. The maximum amount of any disbursement from the petty cash fund should be set by formal action of the board of directors.
- (144) Recognition must be taken of the fact that the limited number of employees in the average borrower's office precludes the establishment of an adequate and effective system of internal control to protect against all possible dangers in recording cash transactions. The auditor must be able to judge the effectiveness of the office procedure in relation to the internal control possible in any particular situation. For instance, when the auditor finds a bookkeeper performing the duties of cashier, accounts receivable clerk, check countersigner, and petty cash custodian, he must be able to determine the extent to which he must make a detailed check of transactions to assure that the financial statements he presents in his report are accurate and reflect the true financial condition of the borrower. Therefore, it is essential that the auditor make a sound evaluation of the system of internal control and its effectiveness so that the detailed tests performed will be an accurate measure of the accuracy of accounting records for all cash transactions. This evaluation is important to the audit program because (1) it will help to avoid unnecessary detail checking, and (2) serve to make the testing procedure more effective.
- (145) *Verification of Accounting Records.* The auditor will find, in making a detailed test of the cash accounting records, that other ledger account entries will be tested in the same operation. For instance, in the detailed examination of cash disbursement records for general cash, the auditor will examine the original accounting evidence supporting some of the entries in the expense accounts. When the original invoice or document supporting any entry in a general ledger

account has been verified and examined, the auditor should mark the entry he has verified with a small distinctive mark. Later, when he examines the entries in this particular account, he will know which entries have been previously verified in connection with the examination of other accounting records. In most cases, the auditor will find that the necessary test-check for many accounts can be performed in connection with the examination of cash accounts. The auditor should always strive to eliminate any duplication of work performed and careful planning of the test-checking procedure to be followed will aid the auditor to make the most efficient use of his time.

(146) *Scope of Verification.* The verification for cash account balances is divided into three separate procedures, (1) reconciliation of cash on hand, (2) verification of petty cash, and (3) bank reconciliations. Some procedures, included in these paragraphs, apply to the verification of accounting records for specific accounts involved and are included under the verification of account balances because the procedure relates to the verification of a specific cash account.

(147) *Reconciliation of Cash on Hand.*

1. Count cash on hand in the presence of the employee responsible for the change fund, prepare cash count schedule and have the responsible employee sign the schedule as receipt for the cash fund returned to him. Care should be exercised that all cash on hand is held in control until all funds have been counted, since the cash on hand may comprise cash receipts not only from the general fund, but also from the installation loan fund, or receipts to be deposited in the REA construction fund account. The auditor should also be alert in the matter of detecting possible shortages when IOU's or checks are found to replace the cash supposedly on hand and to any abuse of the change fund by employees.
2. The dates of the checks on hand should be examined to disclose any mishandling of the change fund. Verify, when counting cash on hand, that all checks other than those cashed for others, included in the cash on hand balance, have been recorded in the appropriate cash receipt book.

3. Count all cash funds at the same time. This will prevent the transfer of cash from one fund to another to cover a discrepancy. Reconcile cash on hand with cashier's record of undeposited receipts. Prepare reconciliation of cash on hand with receipts from audit closing date to date cash was counted.
4. The undeposited receipts included in the cash count should be deposited in the bank intact. If this is impossible, the checks, drafts, money orders, postal notes, etc., included in the cash count, should be traced to the subsequent deposit.

(148) *Verification of Petty Cash.*

1. When the borrower maintains an imprest petty cash fund, the auditor should count the cash on hand in the petty cash fund at the same time as he counts the change fund. The cash should be counted in the presence of the employee responsible for the fund and the cash count schedule should be signed by this employee as receipt for the cash fund returned to him.
2. The amount of the petty cash fund must be established in accordance with a formal board resolution and should be verified by the auditor by referring to the minutes of the board meeting.
3. The auditor must determine the method of handling the petty cash account and the extent of internal control over the transactions involving this fund. The examination of the petty cash fund should be performed so as to include a test-check of the petty cash reimbursement checks and supporting vouchers and a verification of the transactions for a period which coincides with the examination of cash in the bank and other records.
4. The auditor should be concerned with the type of items and purposes for which petty cash is used; for example, the payment of salaries through the petty cash fund is not considered a sound procedure. Usually the resolution establishing the petty cash fund will limit the amount which can be disbursed through this fund. The auditor

should determine that the fund is handled in accordance with that resolution. If the resolution does not limit the amount of a single disbursement, any invoice for a large amount should be questioned, and the auditor should investigate and determine the propriety of the disbursement. The auditor should further examine the reimbursement receipts for the purpose of noting that the petty cash vouchers or invoices are authentic and have been approved by the manager and also by the board of directors through a resolution in the minutes, if that is the borrower's policy. It is also important to note on the petty cash vouchers and receipts the general fund check number of each in order to effect a cancellation of the voucher, so that it will not be used over again on another reimbursement.

5. Predated checks and IOU's of employees should be investigated and the manager's attention should be called to the fact that the petty cash fund should be used only for small current payments of freight, postage, and other miscellaneous items and must not be used for purposes other than those for which it was established.
6. Any irregularities found should be included in the auditor's comments. Auditors should always bear in mind that the petty cash fund should never be used for a change fund. Where it is found that the petty cash fund is not being handled on the imprest system, recommendations should be made for the installation of such a system. Where it is found that a borrower has not set up a change fund, the auditor should make the recommendation that such a fund be established. He should further determine the frequency of the bookkeeper's undertaking to reconcile by physical count the petty cash fund. It is the duty of the auditor to bring to the attention of the management that this fund should be entrusted to one employee only, and this employee should be responsible for the maintenance of this fund and its reconciliation at stated periods. Where it is found that IOU's have been paid from this fund in recurring periods, the auditor should emphasize this fact in his audit report, in order to bring about a

possible discontinuance of such a practice.

7. The auditor should reconcile this account with the general ledger balance.

(149) *Bank Reconciliations.*

1. Obtain all bank statements and cancelled bank vouchers for the period under review. Reconcile bank balances as of the audit date with the amounts reflected in the related cash accounts in the general ledger.
2. The deposits shown in transit as of the preceding audit should be traced into the bank.
3. The checks shown outstanding as of the preceding audit date should be traced into the bank.
4. Examine all checks drawn for inter-fund transactions during the last week of the current audit period to determine that they are simultaneously recorded as receipts and disbursements.
5. Verify that receipts reflected in the cash books as deposited on or about the last day of the period, but not shown as credited by the bank on that day, have actually been deposited as claimed.
6. After a thorough investigation of any borrower's checks outstanding for a period longer than ninety days, make a list of these items and discuss with manager. In some instances, the auditor should suggest that the borrower correspond with the payee, especially if the check is for a large amount, in order to determine why the check has not been presented for payment. If any of the checks have been outstanding one year or more, the auditor should recommend that the bank be notified by letter requesting that payment be stopped and that the borrower be notified when such checks are presented for payment so that proper approval for payment may be given if desired. When the bank is notified to stop payment on these outstanding checks, the auditor should remove them from the list of outstanding checks after making the necessary entries.

7. The auditor should determine what safeguards are in effect to keep blank checks from falling into unauthorized hands. Where an auditor finds that the officials authorized to sign checks make a practice of signing a number of blank checks, the auditor should discuss with the manager the danger of such a procedure. This condition, if it exists, should be commented upon in the audit report.
8. Greater care must also be exercised in the examination and verification of checks when it is found that the authorized signatures are those of the manager and bookkeeper.
9. Obtain confirmation from the depositories of the bank accounts which have been active during the audit period as to the balances.
10. Prepare the necessary schedules reconciling the cash accounts.

(150) *REA Construction Loan Fund.* This audit procedure requires a verification of REA construction fund transactions for the audit period. Since both budget and ledger accounting are involved in this verification, it is important that the auditor understands the difference between the two phases of accounting. For the purpose of this discussion the two terms are defined as follows:

Budget accounting refers to the distribution of debits and credits arising from construction fund transactions to the proper budget classifications established in the REA master budget for the construction loan.

Ledger accounting refers to the distribution of these debits and credits arising from REA construction loan transactions to the proper ledger accounts as established in the REA Uniform System of Accounts.

These two accounting phases are separate and distinct and no attempt should be made to correlate them because each serves a purpose independent of the other. The budget classification of a particular item does not determine the accounting classification for the ledger treatment; neither does the ledger accounting treatment determine the budget classification of any item.

- (151) Budget accounting is established as a control over the disbursement of loan funds to insure that they are used for proper purposes. Before an allocation is approved by the Administrator, a feasibility study is made of the proposed system to determine the soundness of the loan. This study is based on an estimated cost to build the number of miles of line required to serve the members and the potential members of the cooperative. The allocation, which is based on the estimated cost of the system, is broken down to specific items necessary to construct the system and place it in condition to be operated. This breakdown is known as the master budget. All advances to the borrower are made on the basis of specific purposes provided for in the master budget and loan funds may be disbursed only in accordance with these purposes. Unauthorized disbursements, representing expenditures for purposes not provided for in the master budget, violate the loan agreement and can endanger the soundness of the loan.
- (152) Ledger accounting is concerned with the determination of accounting disposition of disbursements from loan funds and advances from REA. The accounting for loan funds follows the outline of the accounts as provided in the REA Uniform System of Accounts. The same criteria for determination of accounting disposition of expenditures is applied both to general fund and construction fund disbursements. For example, an item classified as an expense in accordance with the REA Manual of Accounts is accounted for as an expense regardless of the source of funds for such item. Similarly, an expenditure for an item classified as a capital item is accounted for as such an even though the disbursement may not be authorized or allowable from construction loan funds.
- (153) The responsibility of the auditor is two-fold; (1) he must determine the propriety of the disbursements and the supporting accounting evidence and (2) he must determine the proper accounting disposition both to the budget classification and the ledger account classification.
- (154) The audit working papers discussed in Part V of this handbook, include analyses of construction fund transactions. The textual material related to the working papers describes the information required to be shown in support of the verification made by the auditor.

- (155) The determination of the propriety of construction loan fund transactions includes the adequate support of the transactions with acceptable accounting evidence as well as propriety of disbursements from the standpoint of the construction budget. All cancelled checks must be examined for propriety of purpose, signatures, counter-signatures and endorsements. The rules governing the adequacy of evidence supporting disbursements from other funds generally apply the same as for disbursements from construction funds. All construction fund disbursements, except disbursements to contractors and engineers, must be supported by vendors' invoices. Disbursements to contractors and engineers must be supported by appropriate receipts. Ordinary precautions must be exercised in determining that such goods or services were actually received by the borrower and were received for the borrower's exclusive benefit.
- (156) The propriety of disbursements from the standpoint of budget purposes must be determined in accordance with the prescribed rules and regulations. These requirements are fully set forth in bulletins issued by the Finance Division and will not be repeated here. The auditor must be thoroughly familiar with these requirements so that he can determine whether the disbursements are allowable by these established requirements. The auditor is also responsible for the determination that the disbursements are provided for in the budget, and that funds have been advanced by REA for the purpose covered by the disbursement. The REA Manual of Accounts governs the ledger accounting disposition of all disbursements. The auditor will verify at least 40 percent of the accounting and budget distribution in the cash disbursement record.
- (157) When verification of REA construction fund transactions has been completed, the auditor will prepare a draft of the adjusted expenditure report. After this portion of the audit has been completed and all adjustments and re-funds have been made, the auditor should see that a debit-credit adjustment expenditure report is prepared from such draft and submitted by the borrower.
- (158) The auditor will find many cases in which the borrower makes disbursements from the general fund and periodically draws construction fund checks to reimburse the general fund expenditures allowable from loan funds. In verifying these reimbursement transactions the auditor must examine the documents supporting the

original general fund transaction in the same manner that he examines and verifies all other construction fund disbursements.

- (159) The borrowers should be encouraged to maintain adequate schedules detailing the general fund checks and budget purposes for each item included and the special construction check number and amount which effected reimbursement. The auditor should verify these schedules and refer to them in support of his verification of the reimbursements.

INVESTMENTS

- (160) Investments are generally divided into two types according to the purpose of the investment. One type represents investment of excess funds, primarily for the purpose of producing revenues, or investment of sinking funds. The status of this type is more or less "fixed" and the principal is not considered available on demand, or, in the case of sinking funds, is not available for any purpose other than that for which the fund was originally created. The other type represents investments of funds which are in excess of the current needs of the borrower and are temporarily invested to reduce cash balances in the bank. The principal of these temporary cash investments is available on short notice and can be considered part of the borrower's working capital. The procedure for the verification of investments of both types is generally the same.

- (161) *Verification of Account Balances.*

1. Examine the bonds or other securities and ascertain that they are properly issued in the name of the borrower. If they are registered in the name of an officer of the borrower, see that they are accompanied by a power of attorney or are endorsed by the registered owner.
2. The securities examined should be checked with a detailed listing of the securities owned and the total thereof should be in agreement with the general ledger accounts. A separate schedule should be prepared for each investment account.
3. Verify receipt of all interest earned on the investments:

- (a) Coupons or other interest collections.
- (b) Increase in value of the appreciation type of bonds which may be included in the schedule.
4. Determine that investments acquired by restricted funds are not intermixed in the same account with those purchased from general or non-restricted funds.
5. When the securities cannot be obtained for examination and are held by a custodian, obtain a confirmation letter listing the items held by them. This letter of confirmation should be made a part of the audit working papers.
6. When securities are kept in a safe deposit box, indicate the name and address of the bank and the name of the individual in whose name the box is held if it is not held in the name of the borrower.
7. Indicate in the audit report what securities, if any, are pledged by the borrower as collateral for a loan. The securities pledged for loans should be verified by confirmation from the lender.

NOTES RECEIVABLE

(162) Loans made to borrowers' members for wiring and purchase of appliances or equipment are evidenced by notes receivable. In most instances, the borrower makes these loans from funds advanced by REA for this purpose, and the individual notes signed by the members are the collateral securing the REA obligation. The auditor must examine these notes and determine that they represent collateral sufficient to cover the REA obligation for these loan funds.

(163) *Verification of Accounting Records.*

1. Test the borrower's calculation of interest on notes receivable collections to determine the procedure followed and the accuracy of amounts. This testing should be confined to a portion of the transactions occurring within the period for which cash receipts records were tested. The

auditor should examine enough transactions to be reasonably sure the records are correct.

2. Verify footings of a portion of the individual accounts in the subsidiary ledger.
3. Verify the footings in the general ledger control account.

(164) *Verification of Account Balances.*

1. Request the borrower to prepare a schedule of notes receivable unpaid at date of audit. If it is prepared by the borrower, the auditor should check it for accuracy.
2. Determine the amount of principal delinquent and age notes listed on the schedule.
3. Compare schedule of notes receivable with the notes receivable subsidiary ledger.
4. Compare the total of the schedule of notes receivable with balance in the general ledger control account.
5. Examine all of the notes in possession of the borrower for amount, signature and note endorsements. Secure confirmation from borrower's attorney, in event he is holding notes receivable pledged as collateral to REA.
6. Secure confirmation of any notes that are held by others for collateral, or for collection. If any notes receivable are discounted, confirmation of the amount should be obtained so that the contingent liability can be determined.
7. Verify the adequacy of the reserve for notes receivable which are doubtful of collection.
8. Investigate the collection policy of the borrower in relation to the collection of delinquent payments due on notes receivable.
9. Identify on schedule the notes receivable due from employees or officers of the borrower.
10. Obtain confirmation of delinquent notes receivable which may be deemed necessary.

ACCOUNTS RECEIVABLE

- (165) Verification of accounts receivable constitutes one of the important auditing functions of an REA auditor since this is the principal source of cash receipts of an electric cooperative. There are several types of accounts receivable which are classified according to the general type of transaction giving rise to the receivable. The verification procedure prescribed herein applies to all types of accounts receivable.
- (166) The extent of internal control exercised over accounts receivable transactions generally governs the amount of detail checking that will be necessary to test the accuracy of the borrower's accounting records for accounts receivable. In determining the extent of internal control the auditor should carefully study the system of internal check to determine that it provides coverage for all of the following points:
1. Accurate billings on the basis of approved rate schedules.
 2. Billing all consumers each month.
 3. Prompt mailing of billings when due, and proper verification of billings before mailing.
 4. Proper maintenance of meter reading records to support billings.
 5. Proper control over itemization of penalties and discounts, and authorization for waiver of penalties and discounts.
 6. Proper authorization for accounts receivable charged to the reserve for uncollectible accounts.
 7. Maintenance of accounts receivable subsidiary ledgers by employees who do not have access to the general ledger, and who do not act as cashiers.
 8. Proper maintenance of subsidiary ledgers and periodic reconciliation thereof with the general ledger controlling accounts.
 9. Maintenance of a consistent collection policy.

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10. Control over approvals for debit or credit adjustments.

(167) After the auditor has established the extent of the borrower's internal control, emphasis should be placed on the testing of the records wherein the control appears to be inadequate. The following verifications are in addition to the test-check procedure.

(168) *Verification of Accounting Records.*

1. Check the footings of a portion of the individual accounts appearing in the subsidiary accounts receivable ledgers. It is recommended that the auditor test-check the footings of accounts showing a delinquent balance.
2. When required, prepare analysis of the changes in the controlling accounts for the period of audit. This schedule is also used to tie-in the billings or sales and the write-offs of accounts previously reserved.
3. Check the footings of the general ledger controlling accounts.

(169) *Verification of Account Balances.*

1. Obtain from the borrower the trial balances of the subsidiary ledgers as of a convenient date. Reconcile the totals thereof with the balances of the general ledger accounts as of the audit date.
2. Check the trial balance of the subsidiary ledgers with the individual items appearing therein to determine that all individual accounts are included. If the number of individual accounts is extremely large, a test-check can be made of the individual balances to determine accuracy.
3. Age the accounts showing a delinquent balance and prepare a schedule showing the result. The age of the delinquent accounts should be determined from penalty date. For instance, if a billing is made on May 25 and the penalty date is June 10, the account would be shown as current in an audit report for the period ending May 31, and would be shown as 1 to 29 days

delinquent in an audit report for the period ending June 30. The auditor can use the summaries of the bookkeeper's schedules showing the age of delinquent accounts if the borrower's office procedure provides for periodic accumulation of this information and preservation of the schedules setting forth the detail of the delinquent accounts.

4. Determine that accounts receivable from employees, officers or directors of the borrower, which do not arise from the normal course of business, are not intermixed with accounts receivable from patrons. Such accounts should be stated separately on the balance sheet.
5. Determine that no accounts receivable are assigned or hypothecated. If delinquent accounts have been turned over to the borrower's attorney for collection, obtain a list of such accounts so that the adequacy of the reserve for uncollectible accounts may be properly evaluated.
6. Test adequacy of reserves for uncollectible accounts of each type of accounts receivable. In this connection, review with the manager all accounts delinquent 90 days and over to determine what steps are being taken to collect these accounts.
7. Confirm balances in the accounts receivable ledgers to the extent deemed necessary.
8. Prepare audit working papers showing the extent of verification performed in detail and results of this detailed examination of accounts receivable.

(170) *Special Considerations.*

1. Overpayments, representing less than a normal charge for a full month's service, are properly recorded on the borrower's records as a credit balance to the accounts receivable ledger account. The auditor should be sure that such credit balances are set forth separately on the schedule aging the accounts. The comments should state the gross amount of the accounts receivable, less these credits, arriving at a net

balance receivable. When credit balances are proportionately large, they should be shown under the liabilities section of the balance sheet.

2. If the auditor finds that the borrower does not make a reconciliation of the subsidiary ledgers with the general ledger control account, he should recommend that this be done at the close of each month or at the time when the least number of accounts are open--usually shortly after penalty date.

For large cooperatives, which carry receivable accounts of 1,500 and over in number, it is recommended that a breakdown of the general ledger controlling account be maintained either by sections or by alphabetical sequence. This is recommended for the reason that it affords an easier method of reconciling differences between the general ledger control account and the subsidiary records. Differences can be localized to one section or one particular group of accounts receivable which will materially reduce the volume of checking to be performed in locating errors. Separate notations should be provided on the daily cash collection sheets for each subdivision and the total of all subdivisions posted on a master control sheet. Similarly, the journal entry recording charges to accounts receivable should be broken down to the proper subdivision of the control account.

The procedure to facilitate reconciliation of subsidiary accounts receivable ledgers with the controlling accounts also provides for proving posting to the subsidiary ledgers daily. This is particularly important for borrowers which have a large number of active accounts, involving 100 or more transactions daily. It is obvious the locating of bookkeeping errors in posting would be difficult if the transactions for an entire month had to be reviewed. In order to localize errors within a shorter period, the process of proving the daily cash receipts postings and the posting of charges to the individual subsidiary ledger accounts by means of running a tape on the debits and credits posted to the subsidiary accounts each day is recommended. This procedure provides for the identi-

fication of all postings made each day and addition of the identified items to determine that the total of the postings agrees with the total of the original records from which the postings were made. In the case of cash receipts, the bookkeeper should place a tab in front of each subsidiary ledger account page after posting the credit to the individual account. After all transactions on the daily cash receipts sheet have been posted, the bookkeeper should run a tape on all the accounts posted that day as identified by the tabs. The total of the postings, as shown on the tape, should equal the total shown on the daily cash sheets. A similar procedure should be used for checking entries for energy charges to the individual accounts. A different colored tab should be used to differentiate between the credit tabs and the debit tabs. However, when an entire ledger is being posted, as in the case of monthly charges for energy, it will not be necessary to use tabs since a tape should be run on all postings in the entire ledger to prove postings.

It is extremely important that the auditor recommend some approved method of reconciliation of the accounts receivable subsidiary ledgers with the controlling accounts when he finds that the borrower does not reconcile periodically or finds the method used is inefficient. This is particularly important when the subsidiary records are not in agreement with the control account.

3. When the tapes on the subsidiary records show the accounts out of balance with the general ledger control account, the auditor should discuss the situation with the manager. After careful examination, any small differences should be adjusted, if properly substantiated, to an expense or revenue account. Any large differences should be established in a deferred account, thus bringing the control and the subsidiary accounts into balance as of the audit date. However, the auditor should recommend that these differences be traced immediately and it may be necessary for the auditor to supervise the work in this connection. The auditor should bear in mind that it is not his function to perform the clerical checking necessary to bring these records into agreement but it is his function to give supervisory assistance in completing this work.

MATERIALS AND SUPPLIES

(171) Materials and supplies are divided into two major classifications based on the purposes for which they are held. These are:

1. Materials purchased for construction, operation and maintenance of the electric system.
2. Materials purchased for resale to patrons.

These major classifications are sometimes subdivided into other classifications representing materials and supplies purchased for specific purposes. The audit procedure outlined herein applies to the examination of all materials and supplies accounts. However, since the most important of such accounts reflect transactions involving materials for construction, operation and maintenance of the electric system, the auditor will find more emphasis placed on procedures applying to this particular classification of materials accounts than others.

(172) As stated previously, the extent and adequacy of internal control will govern the amount of detailed checking necessary to verify the accounting records and the account balances. In determining the adequacy of the borrower's control over material transactions, the auditor should ascertain that the following safeguards are provided:

1. Consistent use of purchase orders which are numbered serially. The orders should be prepared in triplicate, should show the quantity ordered, description of items, unit prices, extended cost and shipping instructions, and should be signed by an authorized employee of the borrower. The original should be sent to the vendor, the duplicate filed numerically, and the triplicate held to check materials when received.
2. An adequate procedure for receiving materials and checking materials received, which provides checking of the packing or receiving slip with the triplicate copy of the purchase order, maintaining records showing unfilled purchase orders, and inspection of the physical condition of the materials received, and recording the proper allocation of freight charges.

3. An adequate procedure to insure that all material invoices are checked with receiving slips, that units, unit prices, and extensions are verified and that all entries to the control account are entered in the subsidiary records. This also includes a filing procedure which gathers all the related documents together to support the payment of any materials invoice, such as purchase order, packing slips, duplicate freight or express bill, order acknowledgements, and the invoice. Approval of the various items involved should be indicated on the invoice by the employee responsible.
4. Proper control over requisitioning materials from stores and returning unused or salvaged materials to stores. The procedure for control of junked material should provide proper accounting for proceeds from sales of such material.
5. Proper allocation of charges and credits for materials withdrawn from stock and returned to stock, based on daily records, summaries of daily records, and correct determination of unit prices.
6. Maintenance of perpetual stock records and periodic reconciliation with the control account.
7. Taking of physical inventories periodically and reconciling the subsidiary and control records with the physical count.

(173) *Verification of Accounting Records.*

1. In addition to the test-check, the auditor should peruse the transactions in periods other than the test period and should investigate all unusual items.
2. Prepare analysis of the changes in the control account for the period of audit. This schedule is also used to tie-in the purchases, returns of salvaged material, transfers to construction work in progress and charges for expense items.
3. Check the footings of the general ledger control accounts.

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(174) *Verification of Account Balances.*

1. Obtain the materials and supplies inventory, as of the audit date, if possible, from the borrower. This should be requested very soon after the auditor arrives at the office of the borrower so that it will be available when the auditor needs it. The auditor should also obtain the original inventory sheets which were used by the employees in compiling the physical count.
2. Determine that the present inventory is taken on the same basis as the inventory used in the prior audit. Whenever variation in method is noted, the auditor should review the present method to determine if it is acceptable.
3. If the inventory date does not coincide with the closing date of the audit, carefully examine the transactions occurring between the inventory date and the audit date to determine the propriety of the inventory. If several months have elapsed and the perpetual inventory records are not in good condition so that a satisfactory reconciliation with the ledger account can be made, the auditor should request a new one, preferably as of the audit date. If a new inventory is necessary, the auditor should request this very soon after the start of his audit so that it will be available when needed.
4. Check the completed, typed inventory with the original inventory stock sheets to determine the accuracy of the units shown on the typewritten inventory.
5. Test accuracy of extensions and footings on the inventory. Check the total of the inventory sheets with the general ledger control account balance.
6. Check quantities, unit prices, and extensions of selected individual items on the inventory with the perpetual inventory records.
7. Make a spot check of the number of units shown on the inventory by actually counting some individual items in the stock bins and comparing

with the perpetual inventory records, and reconcile with the inventory count. Ascertain causes of differences, if any.

8. Test the accuracy of the unit prices used in calculating the inventory by spot checking the calculations of unit prices on the perpetual inventory records. Determine that the "average" pricing method has been adhered to during the audit period.
9. Determine that invoices for all materials included in the inventory have been entered on the records of the borrower. All invoices which have not been entered on the books should be taken up and included among the liabilities.
10. Examine the items appearing on the inventory to determine that only those items properly chargeable to materials and supplies accounts are included. Also examine the individual items for anything unusual which should be checked in detail.
11. Determine that materials received on consignment have been excluded from the inventory.
12. Determine that the liabilities for materials, representing partial shipments on contracts or orders which have not been invoiced, are included on the books.
13. Test allocation of freight and similar charges to the material records to determine propriety.
14. Obtain an inventory certificate from the manager which is properly signed by the individuals responsible for the quantity, quality and usability, and prices and extensions of the materials shown on the detailed inventory. This certificate should also set forth the dates of the inventory and method used in taking inventory.
15. Reconcile the total of the detailed inventory with the balance in the general ledger account. It is safe to assume that there will generally be a difference between the physical inventory and the general ledger control account. The

following procedure should be adhered to in handling these differences:

- (a) Where small, as a result of incorrect pricing, mechanical errors, unaccounted for loss and breakage, etc., the difference should be charged or credited directly to stores expense-clearing.
- (b) Where the difference is substantial and the cooperative personnel is unable to determine its cause to enable making the appropriate entries, it should be suspended as a deferred item. In this event, the borrower's personnel should be given suitable instructions for further detailed checking of the records to locate the difference.
- (c) If the difference is substantial, and a reasonable attempt has been made to locate it without results, the matter should be referred to the borrower's board of directors for its review and disposition.

Suitable comments should be included in the audit report to indicate the auditor's actions and recommendations with respect to the differences.

16. Prepare the schedules and analyses for the audit report. Indicate extent of detailed tests performed in the course of the examination.

PREPAYMENTS

- (175) A prepayment is defined as a payment made by a borrower for specific services or benefits which have not been received during the current period. Prepaid insurance, sometimes referred to as unexpired insurance premiums, prepaid interest, prepaid taxes, and prepaid rents, are the accounts of this classification most commonly used by the borrowers. The auditor's chief responsibility is to determine that the balance, indicated in the borrower's records as prepaid, actually represents a prepayment applicable to future accounting periods. Since all prepayments are basically the same, the verification of the accounting records is similar and the procedure set forth in the following paragraphs will apply gen-

erally to all prepayments.

(176) *Verification of Accounting Records.*

1. Test the accuracy of the charges to the general ledger accounts designated as prepayments. This may be accomplished by spot-checking, but if the auditor should find it necessary, he may examine the original evidence supporting all charges to prepayment accounts.
2. Ascertain that charges made to the prepayment accounts actually represent legitimate prepayments for services which will be received by the borrower in future accounting periods.
3. Examine the borrower's subsidiary records which support the entries for amounts written off during the audit period, and test for accuracy.
4. Test the borrower's method of determining the balances remaining in the various prepaid accounts as of the audit date.

(177) *Verification of Account Balances.* Since the verification of the account balances varies somewhat for each specific type of prepayment, the general procedure applicable to each major classification is set forth in the following paragraphs.

Prepaid Insurance:

1. Examine the insurance policies and check the policies with the bookkeeper's insurance schedule to determine that all policies are included and correctly stated as to coverage effective dates, amounts of premiums, and the basis for write-off.
2. Determine that insurance charges which are in excess of the prepaid premium are properly reflected as accrued insurance premiums for the particular policies affected.
3. Verify balances of unexpired premiums for individual policies and reconcile total insurance prepayments with the general ledger control account.

4. When required, prepare a schedule for the audit working papers. The auditor should state on this schedule the method and extent of his verification of the balance in this account.
5. When the borrower does not maintain an insurance register, the auditor should prepare such a schedule for the audit working papers which verifies insurance transactions for the period covered by the audit. Calculations for audit adjusting entries should be supported by this schedule.
6. Compare cost value of property insured, as recorded in the accounts, with the coverage of the policies providing insurance to determine adequacy of insurance coverage and ascertain that the insurance practices of the borrower conform with REA requirements.

(178) *Prepaid Interest, Taxes, Rents, etc.*

1. Check original accounting evidence supporting the entries to these prepaid accounts. Examine the prepaid schedules maintained by the borrower to determine adequacy.
2. Check accuracy and propriety of amounts shown as prepaid, and reconcile with the general ledger control account. Determine that such prepayments actually apply to future accounting periods.
3. When required, prepare schedules for the audit working papers. State on the schedule for each account the extent of the verification of the account balance.

(179) *Unapplied Payments - Long-Term Debt.* The auditor should bear in mind that so-called prepayments on long-term debt are not truly prepayments but are technically amounts deposited for future application to retirement of debt. However, they are treated on the balance sheet as a reduction of the outstanding long-term obligation. The verification procedure is outlined in this section with that for various types of prepayments, but the auditor should not include this account with the assets in the balance sheet, since it is to be shown as a reduction in the amount of the long-term liability.

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1. Examine accounting evidence supporting the charges to the unapplied payments on long-term debt account.
2. Determine that the unapplied payments are associated with the specific notes designated by the borrower, if such designation was made by board resolution at the time of payment.
3. Reconcile the balance of the account with the last billing statement received from REA which will show the amount of the "Cushion of Credit" available.

DEFERRED DEBITS

(180) Deferred debits include charges for items or services which have been received by the borrower but the benefits of which can be expected to extend into subsequent accounting periods, charges for which final accounting disposition has not been determined, and extraordinary or unusual expenses which are being amortized over future accounting periods. The auditing procedures to be followed in verification of accounts of this type are similar. Primarily, it is the auditor's duty to determine accuracy and propriety of account balances as of the audit date.

(181) *Verification of Accounting Records.*

1. Examine the borrower's schedule of deferred items to determine the accuracy of amortization calculations of deferred debits.
2. Test charges to the deferred debits accounts to determine that such charges are properly grouped into appropriate accounts and actually represent expenses or charges which should be deferred.
3. Investigate the borrower's policy with respect to deferring charges and expenses and determine if this policy is consistently applied. Particular attention should be given to borrower's handling of deferred charges as of the date of the beginning of the current audit period to determine if it is consistent with the method of handling such charges as of the closing date of the current audit period.

(182) *Verification of Account Balances.*

1. When required, prepare schedules of unamortized balances of the deferred debits accounts. State on each schedule the extent of detailed verification made by the auditor.
2. Verify the accuracy and propriety of balances shown in the deferred debits accounts.
3. Test the borrower's amortization schedules and methods used by the borrower in arriving at the balance shown in the accounts.

UTILITY PLANT

- (183) The utility plant of a borrower consists of all property of tangible or intangible nature devoted to utility service. This comprises classified electric plant in service, construction work in progress, electric plant acquisition adjustment, unclassified plant in service, and other electric and utility plant accounts. The classified electric plant in service may be further divided into Intangible Plant, Production Plant, Transmission Plant, Distribution Plant and General Plant.
- (184) The auditor's approach to the verification of utility plant accounts should be undertaken with the full realization that these accounts comprise from 80 to 90 percent of the total assets of an electric cooperative. The auditor must at all times realize that he is responsible for the verification of charges and credits affecting the utility plant accounts. He must also be on his guard against improper entries and be alert to detect any sign of such impropriety.
- (185) Charges and credits, reflecting additions and retirements or adjustments thereof to the production, transmission and distribution plant accounts, generally arise from contract inventories or force account inventories, the latter comprising summaries of construction work orders and retirement work orders. There are some exceptions, however, and in those instances, invoices and other accounting evidence will be the basis for additions to the plant accounts. It is the responsibility of the auditor to determine that changes in the plant accounts are supported by the proper type of accounting documents. He must verify the accuracy and authenticity of such documents. However, it is a recognized fact that verification of the physical existence

of a section of electric line or extension, completed by contract or by force account, does not rest upon the REA auditor. Properly prepared and certified inventories should be accepted as proof of the physical existence of property shown thereon. The auditor should exercise ordinary precaution in the verification of actual receipt of property for additions which are supported by invoices, vouchers, or other documents.

- (186) In verifying the changes in the utility plant accounts for the period under review, the auditor should, under normal conditions, presume that the accounts have been properly audited during the preceding audit. Therefore, the auditor should generally confine his examination to the changes which have occurred during the period covered by his audit.
- (187) In the following verification procedure, it will be noted that some steps appear to overlap others. The auditor should bear in mind that certain verifications are inter-related to various accounts and such verifications should be used in the examination of all related accounts. In some cases, these overlapping procedures have been repeated in the various audit procedure steps to which they apply to show how the verifications ties in to the accounts affected.
- (188) *Verification of Accounting Records.* The verification of accounting records involves an examination of procedures being followed by the borrower. The auditor must determine the adequacy of the procedures to provide for good accounting records.
 1. Examine the records supporting additions and retirements to the utility plant accounts to determine that all supporting documents are preserved.
 2. Examine the accounting methods to ascertain that the additions and retirements are properly recorded in the financial accounting records.
 3. Examine the work order method used by the borrower to determine extent of borrower's adherence to REA manual for work order procedure.
- (189) *Verification of Account Balances.* Nearly all additions and retirements to the electric plant originate in work in progress accounts and are transferred to the plant

accounts on the basis of certain specified accounting documents mentioned in the first part of this section. Therefore, the auditor is concerned with examination of charges going into the work in progress accounts and of documents supporting transfers from the clearing accounts to the plant accounts, and verification of balances remaining in these clearing accounts. In addition, he is also concerned with verification of those additions which are recorded in electric plant accounts direct from disbursements supported by invoices.

(190) The procedure set forth here will cover all the different general phases to be considered in the examination of the accounts affected. The auditor should carefully note that some schedules or analyses often serve as supporting working papers for several accounts. In no event should the auditor copy details from one schedule to another when reference to one detailed schedule will serve the same purpose. The auditor should always be alert to any possible eliminations of duplication and to the possibilities in extensive utilization of schedules or analyses which show the results of his examination.

1. Verify, in detail, the accuracy of charges to the construction work in progress account for contract construction and for work orders or final inventory covering force account construction for the test period coincident with the period for which other accounting records were tested in detail. The auditor should examine the original accounting evidence supporting these charges and trace them through the work in progress subsidiary records into the general ledger control account. Prepare a schedule stating the method and the result of this detailed verification of basic records.
2. Obtain the borrower's schedule of approved work orders which serve as the basis for distribution of such work orders to the electric plant accounts. Test-check the original approved work orders against this schedule to determine accuracy of distribution of construction units to the proper plant accounts. Determine that retirements, made in connection with construction as indicated on the work orders, are covered by a related retirement work order and, if not,

obtain explanation from the borrower.

3. Verify the balance in the work in progress account from the borrower's work order or force account cost sheets. When the borrower does not maintain an adequate procedure for accounting for these costs, the borrower's personnel should be requested to prepare an analysis of the charges and credits to the construction work in progress account for work orders and force account construction. After showing all audit adjustments on this analysis, the balance shown on the schedule will support the balance in the account.
4. When required, prepare a summary of all charges and credits to the construction work in progress account in connection with contract construction which originated from general funds and from REA construction fund during the period under audit. The analysis should show the allocation of charges as to prime or overhead cost and specific classification of overhead cost.
5. Prepare a schedule supporting distribution of any approved inventories for either contract or force account construction. Show allocation of prime costs of assembly units, as summarized in inventories, to the proper electric plant accounts. Summarize overhead costs and indicate method and basis for allocation of such costs to prime costs. Prepare audit journal entries to effect the distribution of the inventories to the electric plant accounts.
6. Determine that all construction costs representing unclassified electric plant in service, completed by contract, force account, or work orders, have been transferred from the construction work in progress accounts to the unclassified electric plant in service account.
7. Request the borrower to prepare a schedule of work orders which have not been approved by REA, showing work order number and amount involved. This schedule should also show any contract or force account construction costs, for which no final approved inventory is available, and which represent completed electric plant in service.

The total of this schedule should be in agreement with the balance in the unclassified electric plant in service account.

8. Varyify accuracy of retirements of electric plant. Request the borrower to prepare a schedule of retirement work orders and indicate, thereon, those that were verified by the auditor. This working paper can be prepared from the summaries of the retirementschedule prepared by the borrower, if the auditor finds the borrower's schedule accurate. The auditor should note that retirements shown on this schedule will adequately support the retirements shown on the analyses of the plant accounts affected. The auditor should not copy the detail of this schedule on his analyses of the plant accounts affected. Reference to the retirement schedule will be sufficient.
9. Prepare analysis for each electric plant account which shows a change during the audit period. These changes may be made through one or more of the foregoing transfers or they may arise directly from original transactions supported by original accounting evidence. The auditor should make full use of the related schedules in preparing his working papers for these accounts.
10. Prepare analysis of the changes in the intangible plant accounts for the period under audit. The original accounting records should be examined to determine accuracy and propriety of all charges or credits made during the period. Determine whether the borrower is following REA procedure with respect to amortization of intangibles.
11. Examine vouchers and supporting accounting records to verify cost of land or structures and improvements during the current audit period. Separate the cost of land from the cost of structures and improvements. Mortgages and other items should be verified by the auditor.
12. Obtain the borrower's schedules of general plant property which is subject to depreciation. Test a portion of the items shown thereon by physical

examination to verify actual existence thereof. Test-check additions made during the period covered in the audit by examination of the original accounting records supporting the ledger entries. The detailed examination of one month's transactions should represent a major portion of this test-check, depending on the additions to this account during the test period. Examine all entries reflecting retirements of general plant property through sales or other service loss and determine that such entries are accurate and proper. Prepare the required schedules of general plant property.

13. Obtain from the borrower the normal inventory of general plant items which are not subject to depreciation. Test-check a portion of the inventory by physical examination of items listed. Examine accounting procedure to determine that the borrower is following the prescribed methods in maintaining these accounts. The auditor should include the inventory lists, prepared by the borrower, preferably in his audit working papers. Any difference between the value of the physical inventory and the general ledger account should be adjusted.
14. Check propriety of entries made during the audit period to the electric plant purchased account. Prepare an analysis of this account. If an approved inventory is available, prepare a schedule showing distribution of this inventory to the plant accounts in support of the audit journal entry to effect this distribution. Determine the amount of the acquisition adjustment and establish the verified amount in the proper account.
15. Prepare an analysis in summary form of the acquisition account. Test the calculations for amortization and determine that amortization rates have been properly approved.
16. Verify depreciation calculations for electric plant and prepare schedules for the audit working papers. Also show thereon the reconciliation of the reserve for depreciation of electric plant. The depreciation for general plant property which is subject to depreciation, and the reconciliation of the related reserves can be shown on the work-

ing papers for the general plant property accounts. Depreciation charges shown on these schedules should be reconciled to the corresponding expense accounts.

17. When required, prepare a summary of changes in utility plant which will show the balance of each utility plant account at the beginning of the audit period, a summary of changes for plant additions, retirements and reclassifications during the audit period, and the balances as of the close of the current audit period. The balance at the beginning of the audit period should agree with the auditor's working trial balance of the previous audit.

- (191) *Special Considerations.* Inasmuch as the utility plant accounts reflect the value of the security for the Government loan, it is important that various phases of these records and supporting documents should be fully understood.
- (192) *Distribution of Inventories.* The final approved documents which support original entries for additions to the electric plant accounts, built by contractor and force account construction, are known as inventories and final construction work orders or inventories of work orders. These documents contain summaries of units installed, segregated by assembly unit designations, and show the unit cost for each type of assembly. This same basic information is shown on all inventories or work orders. The form of presentation varies between a contract inventory and a work order inventory since the basic accounting records supporting these documents are essentially different. In order for the auditor to understand clearly his responsibility and duty with reference to distribution of inventories, the special characteristics of each type of document and general procedure for distribution are set forth in the paragraphs following each classification.
- (193) *Contract Inventories.* The basic records supporting contract inventories are the vouchers and receipted contractor's invoices. These invoices, detailing the assembly units constructed for which payment is made, must be approved by the borrower's engineer as to quantities and compliance with specifications outlined in the construction contract. The final inventory for a contract is a recapitulation of all assembly units in-

stalled by the contractor, which is, in effect, a summary of all invoices for assembly units installed. It is certified or approved as to quantities, unit prices and extensions before it is transmitted to the auditor for distribution on the borrower's records.

- (194) *Prime Costs.* The final approved inventories represent a prime cost of construction. Prime costs of construction may also include such equipment as meters, transformers and installation costs of these units when the borrower makes the installation on a section constructed by contract. In such cases, the final inventory will not include the equipment installed by the borrower, yet the cost of such equipment and installation costs are a part of the prime costs.
- (195) For the purpose of distributing contract inventories, the auditor should consider "prime costs" to be those costs which are stated in terms of specific assembly units installed at a unit cost and extended to the total cost of the aggregate units installed.
- (196) *Overhead Costs.* The second element of cost involved in construction is the overhead applicable to a particular section, constructed by force account or under contract. In constructing the original section, before commencement of operation, practically all general costs may be considered as overhead construction costs. However, only those costs which are directly incident to construction may be considered as construction costs when the borrower is in the operating stage.
- (197) Overhead costs may consist of the following, when applicable:
1. Interest during construction.
 2. Legal fees and expenses (See SL-9 and 13).
 3. Engineering Fees, contract and force account.
 4. Final inspection fees.
 5. Supervision, manager's allocated time and expenses.
 6. General office salaries and expenses.
 7. Transportation expense.

8. Insurance and Taxes.
9. Director's fees.
10. Pole numbering.
11. Other related overhead costs.

(198) Overhead costs are classified into two separate groups, direct and indirect. Those overhead costs, such as pole numbering, which can be definitely assigned to a particular assembly unit or group of units, classifiable under a single electric plant account, as shown on the final inventory, are known as direct overhead costs. The second group, known as indirect overhead costs, represent those costs which cannot be definitely allocated to any particular account, but apply to all assembly units constructed on a particular section or job.

(199) Indirect overhead costs should be allocated on an actual percentage basis which the total of these indirect overhead costs bear to the total amount of the prime costs. This percentage is determined by dividing the total of indirect costs by the total of prime costs, of the inventory of the section to be distributed. This percentage is then applied to the prime costs applicable. For example, assume that a final inventory of assembly units totals \$100,000.00 and that meters installed by the borrower (including installation cost) total \$5,000.00, making a grand total of \$105,000.00; also, that the total indirect overhead costs amount to \$12,600.00; $\$12,600.00 \div \$105,000.00 = 12\%$. Assuming further that the assembly units are distributed to the classified plant accounts and the percentage of indirect overhead costs is applied to each plant account, we arrive at the following:

Account No.	Prime Costs	Indirect	%	Total Cost
Account 350	\$ 5,000.00	\$ 600.00	12	\$ 5,600.00
Account 352	15,000.00	1,800.00	12	16,800.00
Account 354	40,000.00	4,800.00	12	44,800.00
Account 355	25,000.00	3,000.00	12	28,000.00
Account 358	10,000.00	1,200.00	12	11,200.00
Account 359	5,000.00	600.00	12	5,600.00
Account 360	5,000.00	600.00	12	5,600.00
Totals	\$105,000.00	\$12,600.00		\$117,600.00

- (200) It is the responsibility of the auditor to determine the overhead construction cost percentage for all inventories distributed by him, and to verify this percentage if the borrower has distributed inventories.
- (201) Direct overhead costs, if any, such as pole numbering, should be allocated directly to the accounts to which they apply. This will result in an increased percentage of overhead for the particular account which should be taken into consideration when retirements of units from the particular accounts affected are made.
- (202) *Combination Inventories.* When a borrower furnished material or labor, the final inventory may be presented in two or more parts. The construction completed by the contractor will be shown as the labor cost, if his contract covers labor only, and will represent one part of the final inventory to be distributed. The borrower's portion of the construction, that is, the materials furnished to the contractor for instance, will form a complementary document to provide the complete inventory of units installed.
- (203) The auditor should always determine that all inventories are distributed to the plant accounts on the basis of assembly units installed so that retirement costs can be quickly calculated when such property is eventually retired from the classified plant accounts. If it is necessary for the auditor to consolidate two or more documents into one, for the purpose of distributing to the plant accounts, a working paper schedule must be prepared setting forth the method used and the detail of the consolidation. The borrower's personnel should make a copy of such working papers and retain them in the office files for future reference.
- (204) *Construction Work Order Inventories.* Construction work completed by force account comprises such work carried on by the borrower whereby the borrower furnished material, labor, supervision and other overhead in construction or additions to electric plant.
- (205) All such construction work involving small extensions should be supported by individual work order cost sheets and when the work is completed, the details thereof must be included in the consolidated work order summaries entitled--"Inventory of Construction Work Orders." The method of maintaining these work order sheets and of preparing the inventories will not

be stated here as complete instructions are included in the "Manual of Work Order Procedure and Related Instructions in Force Account Construction." The auditor is expected to have complete knowledge of this procedure.

- (206) The preparation of the individual work order cost sheet involves the proper allocation of the overhead costs based on a monthly percentage of the total of other costs to the total direct labor costs. The "Inventory of Construction Work Orders" is prepared on the basis of the standard costs of the units of assemblies installed, and adjusted to the actual costs. These matters are fully covered in the aforementioned manual.
- (207) The principles involved in accounting for this type of construction are similar whether a section of line covered by a specific allocation is constructed by force account, generally supported by one final inventory of force account construction for the entire section, or a number of small taps are constructed by force account, generally supported by a series of work order inventories. It is recommended, however, that each large project or section constructed by force account be accounted for in a separate subaccount of 100.32. It can be treated as one large work order when applying the instructions contained in the "Manual of Work Order Procedure."
- (208) *Retirement Work Order Inventories.* Retirements consist of dismantling or removing from service any units or assemblies of the electric plant previously constructed by contract or by force account. The retirements should be recorded on a retirement work order cost sheet showing the value of material returned to stock, the labor and overhead cost of the removals, and the original installation cost, including overhead, of the units retired. Upon completion of the retirement work, these items are included on the "Inventory of Retirement Work Orders."
- (209) The proper accounting for retirements is discussed in the REA "Uniform System of Accounts" and also in the "Manual of Work Order Procedure and Related Instructions on Force Account Construction." The auditor must be thoroughly familiar with the instructions contained therein.
- (210) The auditor should ascertain whether or not the bor-

rower is recording retirements when indicated in connection with construction work orders, and should determine whether replacements of units of property are being erroneously charged to maintenance. By reference to materials transactions involving poles, for instance, which are units of property, the audit should establish the propriety of any charges to maintenance involving poles.

- (211) *Auditing Cost Records.* The maintenance of proper work order cost sheets is essential to proper accounting for additions to and retirements of the utility plant. These cost records must tie in with the financial accounting records and be supported by these records. Any system of accounting for construction cost which does not provide this feature is inadequate and should be replaced with an acceptable cost system.
- (212) The complete tie-in of cost records with accounting records includes the charging of labor, materials and overhead costs to the work-in-progress accounts on an actual cost basis, and the transfer of these charges from the clearing accounts to the utility plant accounts on an assembly unit basis at actual cost. REA procedure for work order construction provides these safeguards for propriety of all charges and credits to the clearing accounts.
- (213) Some of the most common deviations from sound accounting for work order or force account construction are: the practice of charging labor at an arbitrary rate per hour for an estimated number of hours; the practice of charging materials out on the basis of a nut and bolt inventory of the line constructed after these materials are in place; pricing the materials at an arbitrary unit cost; allocation of overhead costs on an arbitrary basis without regard to the proper time-applied basis of allocation; the practice of calculating cost of assembly units installed on some predetermined basis, such as prior contracts costs per unit, without regard to the true cost; and transfer of these arbitrary costs from the work-in-progress accounts to the utility plant accounts. Such accounting malpractices should be condemned since they would make the records worthless and misleading. Sound accounting procedures must always be insisted upon by the auditor.
- (214) An adequate cost procedure with reference to work order construction provides accurate distribution of payrolls

on the basis of time applied to each activity and proper maintenance of subsidiary records supporting the distribution of these payrolls, charging materials to specific jobs when such materials are withdrawn from stock and maintenance of accurate perpetual inventory records, allocation of overheads on a reasonable basis representing a consistent application of the time-applied principle, maintenance of detailed cost records for each job constructed, and reconciliation of clearing accounts periodically with the individual job cost sheets.

- (215) The extent of the detailed checking which will be necessary in the verification of construction costs will depend on the extent to which cost records are tied in with the financial account records. Therefore, the auditor should study the cost procedure used by the borrower to determine its adequacy and accuracy.
- (216) *Donations in Aid of Construction.* The instructions contained in the Uniform System of Accounts prescribed for REA electric cooperatives state that the plant accounts must be maintained on the basis of the original cost to the person first devoting the property to public utility service, plus the actual cost of the property constructed by the cooperative, less the original cost or the actual cost, or part of both, of the property retired from plant.
- (217) In connection with acquisition or construction, advances may be received in cash, services or property as payments toward the cost of the plant. This advance may be of a temporary nature whereby certain allowances are deducted from energy bills, refunds are made upon completion of construction, or other arrangements made for its return. If all or part of this advance is of a temporary nature, it must be credited to a deferred credit account (a/c 241) as "Consumer's Advances for Construction." When the nonrefundable balance has been determined, and the construction has been completed, it shall be transferred to the account "Contributions in Aid of Construction" (a/c 265.1), if the accounting for the contributions is reflected through the use of that account, or to the account "Donations in Aid of Construction--Credit" (a/c 393), if such treatment is not prohibited by state or other regulatory authority.
- (218) In computing depreciation, the cost of properties for which the contribution was made is included in the

plant accounts. As depreciation must be recorded with reference to the net investment of the cooperative, it is necessary to deduct from the depreciation computed on gross plant the amount of depreciation on balances in Account 393, computed at rates used for the class of property associated with the contribution. It is, therefore, necessary that the details of the amounts credited to this account be maintained by the borrower in such a way that the plant accounts to which they pertain are ascertainable. It will be the duty of the auditor to see that this is done and he must verify the correctness of the items included therein. The auditor must include among his audit working papers an analysis of this account and show the breakdown relating to the plant accounts affected.

LONG-TERM DEBT

- (219) Generally defined, liabilities arising from contractual obligations which are payable in a period more than one year from the date of their assumption are considered long-term debt. In most cases, the REA loans represent the major items in this classification. These consist of advances made by the Rural Electrification Administration for the construction of rural power facilities and advances made for installation loans, that is, funds loaned to the borrower for relending to members for installation of wiring, plumbing and appliances.
- (220) The first step leading to the establishment of a long-term obligation by REA, is an allocation of funds based on the loan contract and mortgage. The next step is the recording of notes executed by the borrower against the allocation set up by the loan contract. Ordinarily, the full amount of the notes is not advanced to the borrower at one time but funds are requisitioned as needed. The accounting system, therefore, provides an account indicating the funds which have not been advanced to the borrower. Payments made by the borrower in advance of the terms of the notes are known as "Unapplied Payments" on long-term debt and are sometimes referred to as a "Cushion of Credit." Payments made in accordance with the established amortization schedules also affect the net long-term obligation outstanding. The various accounts reflecting these transactions determine the outstanding principal of the REA obligation.
- (221) The terms of the notes also provide for accumulating

interest on the outstanding principal for a stipulated period and deferring payment of this interest. The total of the accumulating deferred interest less the installments matured, paid or unpaid, represents a part of the outstanding long-term obligation to REA and the net balance thereof should be added to the outstanding principal of the REA notes.

- (222) It is possible for a borrower to have an outstanding long-term obligation with persons or firms other than REA. When such obligations are found to exist, the auditor should also include the amount due according to the notes or contracts evidencing such indebtedness, in this classification of the balance sheet. Notes payable which are not due within one year should be considered as part of the long-term debt.

(223) *Verification of Accounting Records.*

1. Test the borrower's procedure in checking accuracy of interest statements. The auditor should ascertain whether they are checked but, if not, the borrower should be requested to do so. Comment thereon in working papers.
2. Test the procedure used in recording the estimated interest accruals monthly and reconciliation of the accounts with the quarterly billings.
3. Test accuracy of subsidiary accounts or records supporting long-term debt transactions.
4. Examine filing procedure with reference to preservation and safeguarding of all loan documents and interest and principal statements.
5. Examine borrower's recording of advances from REA to determine adequacy with reference to recording the date of issue of REA checks as well as date of deposit.
6. Examine borrower's procedure with respect to proper approval of long-term indebtedness to persons or firms other than REA.

(224) *Verification of Account Balances.*

1. Reconcile borrower's records with REA statements of interest and principal and verify propriety

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of interest accrual as of the audit date. Prepare schedule.

2. Determine that all notes signed by the borrower have been recorded on the books.
3. Determine if interest accruals or maturities and principal maturities are properly recorded on the borrower's books for the period covered by the audit.
4. Determine that all matured long-term debt unpaid, for both interest and principal, is properly recorded as current liabilities.
5. When the REA loan is secured by revenue bonds, determine that the sinking fund provisions of such bonds are being complied with.
6. Reconcile amounts credited to accrued interest for monthly interest charges with the appropriate expense account.

NOTES

- (225) Although it is not the common practice of a typical REA-financed cooperative to borrow funds from sources other than the Rural Electrification Administration, in some instances a borrower will negotiate a short-term loan to carry on its operations. For balance sheet purposes, the auditor should consider notes or loans maturing within one year as short-term obligations.
- (226) The existence of any short-term obligation will be brought to light in the course of an examination of other accounting records. The auditor should carefully watch for approval of any short-term loans by the board of directors when he reviews the minutes of their meetings.
- (227) It is the auditor's responsibility to see that any short-term obligations are correctly stated on the borrower's records and to determine within reasonable limits by ordinary audit procedure that all such liabilities are reflected on the borrower's books.
- (228) *Verification of Accounting Records.*
 1. Test accuracy of footings of the individual accounts in the subsidiary notes payable records.

2. Examine the records to determine whether any notes have been fully paid during the period covered by the audit, and ascertain by physical examination of the paid notes that proper disposition of them has been made.
3. Scrutinize all payments made on notes for the last few days before the close of the audit period for which the checks have not cleared the bank before the close of the period.
4. Examine all notes payable to determine that the cash, materials, or merchandise received, or services rendered were bona fide transactions arising in the normal course of business and were for the exclusive benefit of the borrower.

(229) *Verification of Account Balances.*

1. Obtain the trial balance of the notes payable subsidiary record from the borrower. Check the individual items appearing on the trial balance into the subsidiary record. Prepare schedule.
2. Check the footings of the notes payable trial balance and compare the total thereof with the control account balance, and reconcile.
3. Show those amounts which have matured and remain unpaid separately on the balance sheet, properly designated as matured, unpaid obligations.
4. Confirm outstanding balances as of date of audit and the details of the collateral given, if any.

ACCOUNTS PAYABLE

(230) Accounts payable are those obligations incurred by the borrower which are not evidenced by formal promissory documents. This class of liability is considered current since the extension of credit on open accounts is usually limited to a short period of time, ordinarily on a month-to-month basis.

(231) The auditor should carefully examine the system of internal control exercised by the borrower over accounts payable transactions. The adequacy of this internal

check will largely govern the amount of detailed detailed checking necessary for the auditor to perform. An acceptable internal control system will provide:

1. All entries to the accounts payable ledgers will be made from original accounting records and will be approved by a responsible employee, other than the person charged with making such entries.
2. All payments on accounts payable will be approved on the basis of invoices. The original invoice must be presented with the check for signature when any payments are made.
3. Every invoice recorded in accounts payable will be approved by an employee responsible for receipt of goods or services for the borrower. Such goods or services should be for the exclusive benefit of the borrower.
4. Monthly statements from creditors will be reconciled with the individual account in the accounts payable subsidiary ledger and such reconciliation should be reviewed by a responsible employee.
5. The subsidiary records will be reconciled at the close of each month with the control account.
6. The accounting disposition of liabilities arising from invoiced transactions will be noted on that invoice. If credited to accounts payable the invoice will be so marked. When the invoice is eventually paid, the check number and date of payment will be recorded on the original and all copies of the invoice. This is particularly important when a borrower pays some invoices currently as received, and records some invoices as accounts payable.
7. Control will be maintained over materials returned to suppliers in a manner to provide accurate accounting for all credits arising from these returns. The procedure will provide a follow-up on all return transactions from the shipping of the materials returned to the entry of the credit memorandum or deposit of the refunding check. All checks received from

- suppliers as refunds must be deposited in the bank.

8. If a check is drawn covering an invoice already paid, or if the check is returned by the supplier, such returned checks must be voided and filed with other paid checks.

(232) *Verification of Accounting Records.*

1. Test the footings of a portion of the individual accounts in the subsidiary ledger.
2. Test the borrower's procedure with respect to proper approval of entries in the account.
3. Examine all payments made to creditors during the month immediately following the close of the audit period. Trace all payments back to the accounts payable list as of the audit date to determine that all these liabilities are included in the accounts payable as of the audit date.

(233) *Verification of Account Balances.*

1. Obtain the trial balance of the accounts payable subsidiary ledgers from the borrower. Foot the trial balance and compare the total with the total of the control account.
2. Check individual items appearing on the trial balance into the subsidiary ledger accounts.
3. Check individual account balances with the statements rendered by the creditor.
4. Determine that all accounts payable to officers and employees are segregated and not included with those payable to trade creditors.
5. Investigate all debit balances in accounts payable. Determine that such debit balances actually represent materials returned to suppliers or consist of overpayments to creditors. If there are no liabilities due these creditors, such debit balances should not be deducted from the total credit of the accounts payable, but should be shown on the balance sheet as accounts receivable due from suppliers.

6. Credit memoranda received from vendors should be deducted from the amount due the respective suppliers. If the liability is less than the amount of the credit memorandum, the excess due from supplier should be shown on the balance sheet as accounts receivable due from supplier,
7. Confirm the balances of the individual accounts, if it is deemed necessary.
8. Offset interfund accounts payable against interfund accounts receivable for balance sheet purposes. Such items should be covered by comments on the financial statements.
9. Determine whether the borrower has pledged any assets with creditors as a guarantee for payment of open accounts payable. If so, confirmation should be obtained from the creditor.
10. Prepare schedule for the audit working papers.

MATURED INTEREST AND PRINCIPAL

(234) The terms of the REA loan contract provide for amortization of the principal of the loan and for payment of interest on certain specified dates. When such payments are not made by the borrower in accordance with the loan contract, the amounts due become matured or delinquent. Matured principal is not a part of the long-term debt since it represents a current liability and should be shown in the current section of the balance sheet. Similarly, matured interest should be shown as a current liability and not as a part of the long-term debt or accrued interest.

(235) *Verification of Accounting Records.*

1. The verification of the accounting records for matured interest and principal will be made in the course of verification of long-term debt accounting records.
2. Determine that the borrower follows a procedure whereby unpaid interest and principal, due and payable, are recorded as matured.

(236) *Verification of Account Balances.*

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1. When required, prepare a schedule of interest and principal statements which are due and unpaid.
2. Check total of this schedule with control account and reconcile.

CONSUMERS' DEPOSITS

(237) Deposits made with the borrower by the consumers, as a guarantee for payment of energy charges, are included in this account. State laws vary as to restrictions placed on cash received as deposits. Some state statutes provide for the segregation of this cash from general cash and restrict the borrower's use of such cash to the repayment of deposits or application to energy accounts. Other states require that a certain percentage of the total deposit cash be kept liquid and no restriction on the use of any cash over the required percentage. In the absence of any state regulation, the auditor should determine that a sufficient amount of cash received as deposits is kept in a liquid condition to meet current retirements of consumers' deposits. This account need not be founded unless required by statute.

(238) *Verification of Accounting Records.*

1. Examine the borrower's procedure with respect to periodic reconciliation of the consumers' deposits subsidiary ledgers with the control accounts.
2. Determine whether the borrower is maintaining liquidity of cash received as deposits in accordance with the laws of the state which has jurisdiction.
3. Examine borrower's procedure with respect to return of deposits and application of deposits on disconnected consumers' delinquent accounts. Particular attention should be given to the method by which the deposit is repaid, that is, by cash or by check.

(239) *Verification of Account Balances.*

1. Obtain the borrower's trial balance of the subsidiary ledger of the consumers' deposit ac-

counts.

2. Check the individual items on the trial balance into the subsidiary ledgers. If the volume of deposits is large, a test-check of the individual items is satisfactory.
3. Foot the trial balance and reconcile the total thereof with the balance of the control account.
4. When required, prepare schedule for audit working papers.

ACCRUED LIABILITIES

(240) Since the records of the borrowers must be maintained on an accrual basis in accordance with REA accounting procedure, the auditor will find it necessary to review the various accrual accounts representing the accrued liabilities of the borrower. The auditor must determine that the balance in each of the accounts substantially represents the correct amount which has accrued to date of the balance sheet. He must also determine that all items of expense which are applicable to the period under audit but are not payable as of the balance sheet date are properly recorded in the accrual accounts.

(241) *Verification of Accounting Records.*

1. The test-check made of the books of original entry will determine the propriety of methods followed by the borrower in accounting for accruals and the accuracy of the records maintained.
2. Examination of the borrower's records should be made to determine that a consistent practice is followed in accounting for accruals.

(242) *Verification of Account Balances.* The most important types of accrued liabilities are discussed briefly in the following paragraphs.

(243) *Taxes Accrued.*

1. Determine that the amount shown as property taxes accrued applies to the period under audit by examination of tax assessments and tax bills.

2. Verify the computation of the amount accrued for property taxes. If taxes for the period immediately preceding the date of audit are not due and payable, the amount of taxes paid in the previous year would be used as a guide for the calculation of the amount accrued.
3. Verify the amounts accrued for Federal old age benefit, Federal unemployment, and State unemployment taxes by computation of payments due, but unpaid, for each class of social security tax, based on total payroll for the months covered since the last tax payment.
4. Tie-in tax accruals to the expense accounts affected.

(244) *Interest Accrued.* The verification of this account balance is accomplished in the review of long-term debt transactions and verification of balances in the related long-term debt accounts. The important points to be covered are:

1. Determine that this account balance reflects only the interest which has accrued since the last billing date.
2. Interest which accrued prior to the last billing date but was not paid when due, should be transferred from this account and set up in the matured interest account.
3. Reconcile the book balance of this account with the amount of interest accrued but not payable as of the date of the audit.

(245) *Accrued Rentals.* This account shall provide for the accruals of rentals of property of others, including the unpaid amounts due for pole attachments.

1. Rental agreements should be examined in support of the accruals set up in this account.
2. The auditor should verify the amount accrued under each contract.

(246) *Accrued Employees' Income Tax Withheld.*

1. Verify the balance in the account by reconciling the total amount withheld from employees since the last remittance to the Collector of Internal Revenue, as shown by the payroll records, with the balance shown in the account.
2. Test-check the borrower's application of withholding tax procedure to determine compliance with established regulations.

(247) *Accrued Payroll.* Accrued payroll consists of the salaries and wages earned by the employee as of the audit date but not due and payable until a subsequent date. These accruals are usually found in those cases in which the payroll is on a weekly basis or other periods which do not end with the close of the calendar month. Monthly or semimonthly payroll periods will, in most cases, coincide with the balance sheet date.

1. Determine that the account balance represents salaries which have actually accrued but were not due or payable as of audit date.
2. Determine that amounts payable to employees for past payroll periods are included with accounts payable and are not shown as accrued payrolls.

(248) *Accrued Insurance.* The items included under this caption represent the excess of the earned insurance premiums over the amounts of premiums advanced. This account is used, principally, with workmen's compensation insurance and general public liability insurance.

1. The examination of accruals for insurance premiums should be made in conjunction with the examination of insurance prepayments.
2. The auditor should verify the computation of insurance premiums accrued as of the audit date, and should show the verified amounts on the prepaid insurance schedule.

DEFERRED CREDITS

(249) Deferred credits are items which represent cash or its equivalent received by the borrower in payment for services, materials or property which have not been

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rendered, delivered, constructed or conveyed, at the balance sheet date; items for which final accounting disposition has not been determined; and items which are applicable to future accounting periods. The auditor is responsible for verifying accuracy of the balances reflected in these accounts as of the balance sheet date.

(250) *Verification of Accounting Records.*

1. Examine the borrower's schedule of deferred credits to determine the propriety of amortization bases and amounts for each type of deferred credit.
2. Examine the borrower's procedure in accounting for deferred credits and consistency of application of the procedure.

(251) *Verification of Account Balances.* While the verification for deferred credit account balances is generally the same for all accounts of this classification, the special points involved in two of the major accounts are presented under their respective account titles in the following paragraphs.

(252) *Consumers' Advances for Construction.* The balance in this account should represent cash, material or services contributed for construction purposes, provided that such contributions are refundable in whole or in part at some future date.

1. Verify the borrower's trial balance of the subsidiary records for consumers' advances for construction by checking the open items into the records, by footing trial balance and checking the total thereof with balance of the control account.
2. Examine the basic accounting evidence to establish propriety of such balances. Contracts, applications for service and correspondence should be examined in this connection to determine whether the contributions are refundable.
3. Verify that the cash, or equivalent, received from the consumer as a contribution, has been properly entered in the borrower's accounts.

4. Determine that any advances for completed construction, which are not refundable to the consumer under the terms of the agreement covering such contributions, are transferred to the proper account.

(253) *Consumers' Energy Prepayment.* The amounts includible herein are those which represent advance payments made by consumers to be applied to future energy billings. Some consumers are served under contracts stipulating minimum annual charges and other consumers voluntarily make payments to cover several future energy billings. Both types of advance payments are to be recorded in this account classification.

1. Obtain the borrower's trial balance of the subsidiary records for consumers' advance payments, check the individual items into the subsidiary ledger accounts, foot the trial balance and compare the total thereof with the general ledger control accounts.
2. Verify the accuracy of individual balances by a test-check of the debits and credits in the accounts.
3. Prepare schedule for audit working papers.
4. Confirm the balances of individual accounts, if deemed necessary.

CONTRIBUTIONS

(254) Contributions received from consumers are usually for two purposes, 1 - Aiding construction, and 2 - Servicing of long-term debt. These are set up in separate accounts in the ledger and they should be shown in the balance sheet under a separate classification. It is the auditor's responsibility to verify the balance in these accounts.

(255) *Verification of Accounting Records*

1. Examine the borrower's procedure with respect to maintenance of proper subsidiary records to support the control accounts.
2. Examine the borrower's procedure with respect to accounting for noncash contributions to determine

that all such contributions have been properly recorded and accounted for.

3. Determine that contributions representing completed construction are properly accounted for on final construction work orders.
4. Determine the procedure pertaining to the segregation of cash arising from the billings to consumers as "Amortization Charges" and for the remittances of the funds collected.

(256) *Verification of Account Balances.*

1. Analyze the account of amounts received in aid of construction to determine that all items represent contributions which are not refundable, in whole or in part.
2. Ascertain whether the use of the account for donations in aid of construction is subject to supervision by any regulatory body in the State and, if so, what action has been taken, if any.
3. Determine that the construction for which the contribution was received has been completed and, if so, that the contribution not in excess of the cost has been transferred to the account "Donations in Aid of Construction--Credit," unless not permitted by state regulatory body restrictions.
4. Reconcile the special cash account containing collections from consumers for the express purpose of servicing long-term debt with the amounts billed to consumers.
5. Prepare schedule for audit working papers.

MEMBERSHIPS

- (257) The amount of the membership fee is usually set by the by-laws of the borrower. The provisions for refund of membership fees, termination of memberships, and forfeiture of membership fees are also stated in the borrower's by-laws. The auditor should, therefore, be guided by the regulations of the borrower when he reviews the several accounts reflecting these membership transactions.

(258) The membership fee should accompany the application for service. This fee is recorded at that time as a membership subscribed but unissued. After the borrower has accepted the application for service through formal action of the board of directors, a membership certificate is issued to the applicant and the fee is then transferred to the memberships issued account. From the auditing viewpoint, therefore, it is essential to determine that the fees are recorded in the appropriate account.

(259) In order to determine that such fees are properly recorded, the auditor should examine the underlying accounting evidence supporting the entries in the borrower's records. The first basic document of the records for membership fees is the application for membership signed by the applicant. The duplicate cash receipts for membership fees constitute the basic record. The duplicate cash receipts book and the duplicate deposit slip, evidencing the bank deposit for such collections, comprise the records which support the original entry. The minutes of the board of director's meetings which show approval of the applications support the transfers from the account of memberships subscribed but unissued to memberships issued account. Subsidiary records should be maintained in support of each of these two accounts. For the memberships issued, the subsidiary record should be a register made up from the stubs of the membership certificate books or from a file of receipts for the certificates delivered to the member. A card file, a register or a ledger record of the individual applications forms the subsidiary records supporting the control account for memberships subscribed but unissued. It is the duty of the auditor to determine whether the records are being maintained in accordance with the regulations of the borrower and to verify the account balance.

(260) *Verification of Accounting Records.*

1. Examine the borrower's procedure with respect to acceptance of applications for service, approval of such applications by formal action of the directors, and subsequent issuance of membership certificates.
2. Determine that the borrower's procedure provides for transfer of fees from memberships subscribed

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but unissued account to the memberships issued account when the membership certificates are issued.

3. Test the borrower's procedure with respect to proper maintenance of membership certificate books and proper cancellation of certificates when refunded.

(261) *Verification of Account Balances.*

1. Obtain the borrower's trial balances of the subsidiary records supporting the control account balances for both issued and unissued memberships. Foot trial balances and check totals with the general ledger totals of the control accounts.
2. Test-check the individual items appearing on the trial balance of the memberships issued into the membership certificate books and into the minute book of the board of directors to verify formal approval and subsequent issuance of the certificate.
3. Trace a portion of the individual items appearing in the trial balance of the memberships subscribed but unissued account back to the original signed applications for service.
4. Determine that all subscriptions are recorded in the full amount of the membership fee and that any unpaid balances are recorded as subscriptions receivable.
5. When required, prepare schedules for audit working papers.

MEMBERS' AND PATRONS' EQUITIES

- (262) The capital credits plan was established for the reason that the majority of borrowers from REA are nonprofit organizations and, as such, do not have net income. The theory of service rendered by a cooperative in furnishing electric energy is that the energy is charged at cost and all collections received represent the payment for this service. When the collections are in excess of the cost, the excess represents paid-in capital. This paid-in capital may be refunded to the

patron when the cooperative has accumulated sufficient capital to insure financial stability.

(263) The capital credits plan has been recommended to the cooperatives and they have been urged to institute this plan. The adoption of it necessarily established a basis of accounting somewhat different from that used by a utility which operates on the premise that the excess of collections over costs represent income and such income is to be distributed to the stockholders but not to its patrons. All revenues received from patrons for electric energy billed are credited to an operations clearing account against which all costs of rendering such services are charged. The net credit balance of this clearing account would be transferred to the patronage capital account but, if the cooperative has not established the capital credits plan, the net credit would be transferred to the operating margins account. However, should the net balance in the clearing account be a debit, it would be transferred to the operating margin account whether or not the borrower has established the capital credits plan. It is important to note that all nonoperating revenues and the costs thereof are transferred to the non-operating margin account. It should also be noted that the net gain or net loss on the sale of any capital assets, investments, or other physical property, other than on operating unit of electric plant, are transferred to the capital gains and losses account.

(264) To summarize, the *total* capital of a cooperative comprises the membership fees paid or unpaid for certificates issued or for subscriptions therefor, the patronage capital credits and patronage capital assignable, plus the donated capital and other members' and patrons' equities. The other members' and patrons' equities comprise the operating margins, non-operating margins, capital gains and losses, retired capital credit gain, and other margin accounts. All these accounts, including description of their controls, are fully explained in the "Uniform System of Accounts."

(265) *Verification of Accounting Records.*

1. Determine, by examination of the minutes of the board meetings that assignments, if any, to the patrons' accounts of the patrons' capital credits have been approved.

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2. Determine whether or not the borrower's personnel have accurately computed the individual consumers patronage capital and properly assigned same to the individual patrons' accounts.
3. Determine that proper procedure is maintained in accounting for operating margins and nonoperating margins, as well as other members' and patrons' equities.
4. Examine the borrower's procedure and determine adequacy of subsidiary records maintained in support of the general ledger accounts.

(266) *Verification of Account Balances.*

1. Trace entries into the operations clearing account for the period under audit and verify accuracy of such entries.
2. Trace entries of nonoperating revenue and nonoperating revenue deductions into the nonoperating margin account for the audit period and verify accuracy of the items and propriety thereof.
3. Examine all other members' and patrons' equity accounts and verify propriety.
4. Analyze and reconcile all general ledger accounts relating to patronage credits.
5. Test-check recordings of patronage capital credits to individual patrons.
6. Analyze entries affecting the miscellaneous debits and miscellaneous credits to patronage capital and to other equities to determine whether or not (1) they can be charged to current year's operation, (2) they are of sufficient size to warrant adjustment of patronage capital assigned or assignable for prior years.
7. Prepare schedules for audit working papers.

SURPLUS

- (267) In those cases where the borrower is not a nonprofit cooperative, certain accounts must be substituted to

conform with the accounts prescribed by the Federal Power Commission. Section XVIII of the REA Uniform System of Accounts presents the accounts which are to be substituted. The principal change is the substitution of the earned surplus accounts and accounts for adjustments thereto for the accounts reflecting equities of members and patrons.

(268) Earned surplus includes the net income or loss arising from operation of the enterprise, that is, total revenues less expenses and gains or losses arising from the sale of property. This class of surplus can be appropriated for specific purposes by formal action by the board of directors. However, all reservations of earned surplus are shown under the net worth section of the balance sheet and are not applied to offset a contra account. In this connection, the auditor should determine that all reserves classified as surplus reserves are actually reservations of earned surplus and are not valuation reserves.

(269) In addition to the earned surplus accounts the auditor must take into consideration those accounts reflecting miscellaneous debits or credits to the earned surplus account. These accounts reflect amounts which, although entered in the current year, affect the earned surplus of some prior period. This procedure of segregating adjustments for prior periods from the accounting of the current period makes it possible to determine the actual earned surplus arising from any calendar year's operation. At the end of each accounting period, that is, at the end of each calendar year, these adjustment accounts are closed into the earned surplus account, and the current revenue and expense accounts are not distorted or affected by any adjustments for prior operations. The auditor will find entries made by the borrower in these surplus adjusting accounts as well as his entries reflecting audit adjustments to prior accounting periods as determined by the current audit.

(270) The earned surplus balance at the close of any accounting period will be reflected in the earned surplus account since revenue and expense accounts and surplus adjustment accounts will have been closed into the surplus account. However, at any date not coincident with the accounting period, the amount of the surplus will be composed of the balance of this surplus account as shown in the general ledger, the balance of

the miscellaneous debits and credits to surplus accounts and the net gain or loss arising from operations during the current calendar year as shown in the revenue and expense accounts.

- (271) Since the financial condition of a borrower is usually judged from the net worth as shown on the balance sheet and surplus is an important factor in net worth for the measurement of financial condition, the auditor should verify the account balance, and should carefully scrutinize the items making up this balance. It is evident from the foregoing that not only should the surplus account balance be verified, but the operating account balances should also be verified.

(272) *Verification of Account Balances.*

1. If any entries have been made to the capital surplus account, such entries should be examined and verified for the period under audit.
2. Trace entries into the earned surplus account for the period under audit and verify the accuracy of such entries.
3. Examine all appropriations of the earned surplus account, verify authorization of the board of directors and determine propriety.
4. Analyze all entries to the miscellaneous debits and credits to surplus account made during the audit period, including both the borrower's and the auditor's entries, indicate the other accounts involved and show the fiscal years affected so that the reconciliation of the earned surplus by accounting periods can be prepared.
5. Prepare schedules for audit working papers.

OPERATING ACCOUNTS

- (273) The audit procedure includes the verification of accounts reflecting the operations of the borrower for the period under audit. The purpose of examining these operating accounts is to verify the net worth as stated on the borrower's books of account and to determine that all revenues and expenses have been classified to the proper accounts. The auditor should determine that expenses have been charged to the proper accounting period

and that all accrued expenses have been recorded.

(274) The verification procedure should follow the same test-check principle applied to the balance sheet accounts. After examining the representative transactions for the period required to be tested in detail, the auditor should scan the accounts and examine any entries which appear unusual. The auditor will find that the test-check will have been performed for many of the operating accounts in connection with the test procedure for accounting records, and a review of the ledger entries will complete the verification. It is again emphasized that duplication of work should be eliminated as much as possible and all verification procedures should be utilized to improve the efficiency of the auditor's performance.

(275) *Verification of Procedure.*

1. A sufficient number of entries in the revenue accounts should be checked to verify the propriety of the accounting procedure in recording all income.
2. All operating expense accounts should be perused. If the auditor finds an unusual entry, he should trace it back to the original accounting evidence to determine the propriety. The test-check performed in verifying the accuracy of the accounting records will prove to be a valuable guide to the auditor in examining the ledger accounts for unusual entries.

CONTINGENT LIABILITIES

(276) The borrower may have some obligations, the payment of which is contingent upon the development of certain conditions or happenings whereby funds may be required without receiving any equivalent direct benefit or where any recoveries therefor are very doubtful. The contingent liabilities may comprise definite amounts which are ascertainable depending upon the certain developments, or may consist of losses or costs of claims, the amounts of which are undeterminable as of the date of the audit. Examples of these possible liabilities which an REA borrower may incur would be,
 1 - Notes receivable discounted, 2 - Accommodation endorsements, 3 - Guaranties given for products sold, 4 - Losses due to damage claims, 5 - Legal fees and

expenses incurred in lawsuits or claims being litigated
6 - Losses due to lease guaranty, etc.

- (277) The auditor should compile a list of all contingent liabilities indicating thereon the reason for the establishment of each item and its current status. This list should be included in the working papers and the audit comments should contain a summary with proper explanation thereof. The total contingent liability, if determinable, or reference to the matter involved should be shown on the balance sheet, not usually includible in the balancing figures, but normally as a footnote.
- (278) Secure a certificate from the management showing that all liabilities have been entered on the books or have been provided for as of the date of the audit. It is not intended that this certificate be accepted in lieu of an examination and test-check to insure that all liabilities have been recorded, but rather, as a precaution to provide written evidence that the auditor made proper inquiry from the management regarding the existence of liabilities which may not otherwise be determinable from the records.

PART IV
THE AUDITOR'S REPORTS

THE AUDITOR'S REPORTS

PAR. THE IMPORTANCE OF THE AUDITOR'S REPORTS

- (279) The importance of the auditor's reports should be fully realized by the field audit staff. An audit is the examination of accounts and accounting records of a borrower and the auditor's report sets forth the pertinent facts regarding this examination and conclusions drawn as a result of the audit. Therefore, it is apparent that the report should be complete, accurate, and present the information necessary for a clear understanding of the facts established by the audit. Inasmuch as a uniform system of accounts is in use, a standard procedure for audit may be employed and reports of audits prepared in a consistent form. The limitations of standardizing audit reports are recognized, but certain rules can be established which should be followed in the preparation of audit reports. The type of information to be included in comments, methods of presentation of financial statements and terminology can be standardized for all reports. However, the fact that individual problems will be encountered on each assignment cannot be disregarded when standard requirements are established. The presentation of the problems, conclusions and pertinent facts should follow the standards set forth for the sample auditor's report. *Exceptions to standard requirements must necessarily be based on circumstances surrounding the individual case.*
- (280) The auditor's reports form the basis for determination of whether Government funds have been disbursed in accordance with the Rural Electrification Act of 1936, as amended; whether the borrower is complying with the terms of the loan contract, note and mortgage, and prescribed policies and regulations; whether the borrower's affairs are being conducted efficiently; whether the borrower's revenues are sufficient to meet all charges including principal and interest payments; whether the borrower's records and accounts are accurate, clear and complete; and whether the books reflect the true financial condition of the borrower. The auditor's report will also disclose whether problems are being encountered by the borrower regarding which advice, action or assistance by other divisions of REA is necessary.
- (281) The auditor should carefully prepare his report as the

conclusive summary of his work performed in accordance with an assignment. All pertinent facts should be set forth in the proper section of the report. The auditor should bear in mind that his report reflects the accuracy of his judgment in problems encountered as well as his ability in carrying out the requirements of a specific assignment. He should also remember that future action on the part of REA may be based on his report; and, therefore, it should contain all the information essential to a clear understanding of facts disclosed by his examination.

- (282) Reports are prepared by the auditor to present clearly the findings and results of his examination of the borrower's accounts and accounting records. Conclusions drawn from hearsay or assumption must be avoided since comments based on such factors are unreliable. *The auditor should confine his comments to facts supported by his audit working papers resulting from his examination and should not include matters for which he has no direct evidence to support his statements.*

- (283) The manner in which the auditor's report is presented should be clear and concise. Short, simple sentences are most effective, but should be composed to make the report easily read without being too abrupt. The wording and construction of all sentences should be carefully chosen. The comments should be so clearly presented that it will be impossible for anyone to misunderstand or misconstrue the thought being stated. The auditor should bear in mind that the reader of the comments is usually unfamiliar with all the phases of the situation which is the subject of the report; and, therefore, he should never assume that any of the facts are already known to the reader. This is particularly true when a statement is made which draws a conclusion from many facts disclosed by the audit. All conclusions stated must be supported by the facts contained in the audit working papers as compiled during the course of the audit. However, reference in the comments to working paper schedules must be avoided.

- (284) The auditor should always furnish sufficient information to present the facts adequately and clearly but should avoid using unnecessary detailed explanations which do not add to pertinent facts. All inconsequential comments should be avoided if they have no informative value.

- (285) The auditor submits two reports with reference to his audit: (1) An audit report which contains comments on the balance sheet, comments on operations, comments on general matters, and the financial statements for release to the borrower; and (2) a field activities report for administrative use within REA. Comments prepared for release to the borrower relate to information and facts about the borrower's financial condition, accounting records, procedures and practices. The Field Activities Report (Form ADM-36) contains special information for the Administrator, Finance Division, and/or other divisions of REA which is not submitted to the borrower.

THE AUDIT REPORT

- (286) The term "audit report," as it is used in this handbook, does not differ from the usual meaning of the term as it is applied in commercial accounting practice. Some authorities consider the report to be the certificate which is attached to the financial statements the commercial accountant has examined and is based on the contention that the auditor examines statements furnished him by the client and therefore his report includes only his certificate. Other authorities consider the auditor's comments, the certificate and the financial statements as the audit report, which interpretation is based on the fact that the auditor submits this information to his client as the result of engagement and all the data submitted are considered the auditor's report to his client. In this handbook, the term "audit report" refers to the comments, financial statements and other supporting details submitted to the national office by the field auditor, copies of which are to be forwarded to the borrower after review and comparison with the audit working papers.
- (287) It is the purpose of this part of the handbook to set forth general principles to be followed in preparation of the audit report. A sample audit report follows paragraph 305.
- (288) *Comments on the Balance Sheet, Operations, and General Comments.* These comments should be carefully prepared for the use of REA and the borrower in the improvement of accounting records and elimination of improper accounting practices disclosed by the audit. The factual information presented must be supported by the working papers prepared during the audit.

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- (289) The auditor should carefully gather information for these comments throughout his examination of the borrower's records. The most effective method of accomplishing this is to note all items to be discussed in the comments on the balance sheet and general comments at the time such items are encountered in the course of the audit. It is impossible to recall all subjects to be covered in these comments if the auditor relies on his memory alone. Therefore, the auditor should systematically gather this information and record it in a convenient form during the course of his audit so it will be available when he is preparing his comments. A good practice would be for the auditor to make suitable notations or explanations and attach them to or make them a part of his schedules or analyses in the audit working papers. This will insure the value of his comments to REA and to the borrower since no important phases will be neglected and he can properly weigh and evaluate the information to be presented.
- (290) In the general comments the auditor should make recommendations for improvement of the borrower's records and correction of improper accounting practices. The auditor will find it advantageous to discuss with the manager and bookkeeper, before leaving the borrower's office, the recommendations which will be presented in the general comments. Since a copy of these comments is returned with the financial statements to the board of directors, the cooperation of the borrower's personnel may prove helpful in assuring the board's acceptance of the auditor's recommendations.
- (291) It is important that the auditor be very careful when making recommendations for improvement of the borrower's records. Impractical suggestions for changing adequate records merely to conform with theoretical record-keeping principles should not be recommended. Such recommendations result in loss of the borrower's confidence in the auditor and are likely to result in the rejection of the worth-while recommendations for needed revisions of record-keeping procedure. The subject matter of recommendations must be confined to accounting. Subjects with which the auditor is unfamiliar or which are not the responsibility of the auditor should not be included in the recommendations in the general comments. The auditor must also avoid conflict with procedures instituted upon suggestion of an auditor during a prior audit.

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- (292) The auditor should comment on the condition of the accounting records of the borrower. It is through such comments that pertinent facts regarding the records and record-keeping system are brought to the attention of REA, the directors, and the manager. *These statements must be based on the audit examination and must be supported by facts reported in the audit working papers.*
- (293) It is important that the comments cover each item on the balance sheet, and show its composition and the extent of verification. The comments should be clearly worded, concise, and so written that they can be understood by the borrowers. It should be kept in mind that the report is not only being prepared for REA, but also serves the purpose of an audit for the borrower. The balance sheet comments should not refer to procedures of the borrowers or accounting instructions. Such references should be reserved for the general comments.
- (294) Where operations audits have been conducted for the borrower by independent accountants, the audit comments should state the extent to which the auditor accepted the amounts verified by the independent accountants, and reference should be made to the accounting firm and the period covered by its audit.
- (295) It will be noted that the sample audit report contains three types of comments: balance sheet comments, comments on operations, and general comments. Care should be exercised in determining which section the intended comments should appear. The balance sheet comments should be looked upon as formal statements of facts, after the necessary verification, reflecting the financial condition of the borrower at a specific date. The comments on operations need no special definition except that they should be confined to past operating statistics. Ordinarily, such comments should not be projected to future operations. The general comments are statements concerning the maintaining of accounting records and accounts, the adequacy of accounting procedures, and the adherence to the policies recommended by REA.
- (296) The auditor should avoid reference to working papers in his comments. This is necessary because audit comments are read and used by individuals who do not have access to the schedules and analyses included in

the audit working papers. When it is necessary to include figures or amounts detailed in the working papers, the auditor should summarize the amounts and include the summaries in his comments. This practice will make the audit comments an independent report which can be effectively used without having the complete audit working papers for reference.

(297) *Financial Statements.* The result of the examination of the accounts and accounting records is reflected in the financial statements prepared by the auditor at the conclusion of his audit. These statements should be carefully prepared. The financial statements include the balance sheet, statement of revenue and expenses, and schedules of utility plant, capital and other equities, and long-term obligation to REA. In cases of borrowers other than nonprofit cooperatives, a schedule of surplus will be included instead of the schedule of capital and other equities. This schedule of surplus may be a copy of Schedule NN1 for other than nonprofit cooperatives as shown in Part V, Audit Working Papers. These statements generally include the information considered necessary for a complete evaluation of the financial condition of the borrower and should be prepared along the general lines of the sample audit report. In some instances it may be advisable to include other statements in the report, such as schedules of investments and accounts payable.

(298) The balance sheet is the major exhibit of the report and reflects the financial condition of the borrower as at the audit date. The report form of balance sheet is adopted for the purpose of simplicity and to be more readily understood by the layman. It follows the equation that assets less liabilities equals the member and patron equities. Since it is intended that the balance sheet be confined to a one-page report some of the usual refinements found in ordinary statements have been eliminated. The valuation reserves are not shown in the statement but only the net valuation. The total amount of the asset and the amount of the reserve provided is shown in the comments.

(299) In constructing the balance sheet, the utility plant is first shown as a separate item. This amount is supported by Schedule 1. The next classification is Current and Other Assets, under which are listed all items in this category in order of liquidity. In some instances, it may be necessary to include other

classifications such as Permanent Investments or Other Assets. Unexpired insurance premiums will be considered as a current asset.

- (300) In regard to the liabilities section, there will generally be four classifications as shown on the sample audit report. The long-term obligation to REA will be supported by Schedule 3, and should not be detailed in the balance sheet. In most cases it will not be necessary to show the details of the other classifications as the composition can be fully covered in the audit comments. If it should be considered advisable to show the composition of any classification, the detailed descriptions should be properly indented and the amounts shown in a separate column following the example under the Current and Other Assets classification on the sample balance sheet. No separation is recommended on the balance sheet between the amount of the long-term obligation to REA which is payable within one year, and that which is payable after one year. In cases where there is a credit balance in Account 144, Retirement Work in Progress, this amount should be included on the balance sheet under the caption "Other Liabilities and Credits" and an appropriate explanation should be contained in the comments.
- (301) Contributions in aid of construction should not be included in the third section of the balance sheet but should be shown under a separate classification under the Liabilities and Other Credits Section.
- (302) The Member and Patron Equities Section of the balance sheet will include the membership fees, donated capital and patronage capital, and other equities which result from operating and non-operating transactions, and the sale of capital assets. In some instances, these balances may represent a debit amount. In such cases the debit amount may be enclosed in parentheses or if space permits, the items with credit balances should be listed first and a total shown from which would be deducted the debit balance to arrive at the net margins. Under the caption Patronage Capital should be included all amounts of capital credits or patronage refunds which have been recorded in Accounts 201.1 and 201.2, together with the operating margins for the current year (if the capital credits plan is in effect) and any adjustments still to be closed to capital. Other Member and Patron Equities should include the balance

in Account 273.1, if it represents a deficit or if the capital credits plan is not in effect, plus the balance in Accounts 273.2, 273.3, 273.4, and 273.5.

- (303) Where appropriation reserves have been set up such as Reserves for Maintenance, Reserves for Educational Purposes, etc., such reserves should not be included in the Member and Patron Equities but should be included as a separate classification under the Liabilities and Other Credits Section.
- (304) The totals of the Patronage capital and other member and patron equities, respectively, shown on the balance sheet should agree with the summary of these same items which is shown on Schedule 2. In preparing Schedule 2, any excess of revenue over cost for current year should be classified as Patronage Capital Assignable, if the Capital Credits Plan is in effect. If the Plan is not in effect or if there is an excess of cost over revenue, the proper classification would be Operating Margins.
- (305) When the auditor finds accounts receivable and accounts payable recorded in the books for interfund accounts, he should not include these accounts on the balance sheet. Such accounts are contra accounts and, as such, should be eliminated from the statements. However, they should be shown in the general comments with proper explanation.

STATE 23.COUNTY
CENTER COUNTY ELECTRIC COOPERATIVE
TOWN, STATE

REPORT OF AUDIT
FOR THE PERIOD
JANUARY 1, 1945 TO NOVEMBER 30, 1946

INCLUDING:
COMMENTS AND CERTIFICATE
BALANCE SHEET
STATEMENT OF REVENUE AND EXPENSE
SUPPORTING SCHEDULES

UNITED STATES DEPARTMENT OF AGRICULTURE
RURAL ELECTRIFICATION ADMINISTRATION
FINANCE DIVISION

REA

STATE 23 COUNTY

CENTER COUNTY ELECTRIC COOPERATIVE

TOWN, STATE

DIRECTORS

<u>Name</u>	<u>Address</u>	<u>Principal Business</u>
A.B. Adams	R.F.D. No. 3, Center City	Farmer
B. C. Brown	R.F.D. No. 1, Center City	Farmer
J. C. Jones	P.O. Box 37, Marysville	Merchant
S. R. Smith	R.F.D. No. 4, Center City	Farmer
W. W. Williams	R.F.D. No. 2, Center City	Farmer

OFFICERS AND MANAGER

S. R. Smith	President
A. B. Adams	Vice President
W. W. Williams	Secretary-Treasurer
T. R. Thompson	Manager

REA

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STATE 23 COUNTY

CENTER COUNTY ELECTRIC COOPERATIVE

TOWN, STATE

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REA

STATE 23 COUNTY

CENTER COUNTY ELECTRIC COOPERATIVE

TOWN, STATE

We have examined the balance sheet of the Center County Electric Cooperative as of November 30, 1946, and without making a detailed audit of the transactions, have reviewed the record of the cooperative's operations for the period from January 1, 1946, to that date. Our examination was made in accordance with generally accepted auditing standards applicable in the circumstances, and included such tests of the accounting records and other supporting evidence as necessary to determine the effectiveness of the internal check or control maintained by the borrower, and such other procedures which we considered necessary.

We herewith present our report, based upon this examination, together with the following exhibits and schedules:

- Exhibit A - Balance Sheet as of November 30, 1946
- Exhibit B - Statement of Revenue and Expense,
January 1 - November 30, 1946
- Schedule 1 - Utility Plant as of November 30, 1946
- Schedule 2 -- Patronage Capital and Other Member and
Patron Equities as of November 30, 1946
- Schedule 2 - Long-Term Obligation to REA,
November 30, 1946

BALANCE SHEET COMMENTS

ASSETS

Utility Plant	\$550,289.78	
Less: Reserve for Depreciation	23,905.69	\$526,384.09

An analysis of the utility plant is presented in Schedule 1.

For the period covered by the audit, we examined all entries recorded in both classified and unclassified plant accounts, including those for additions and retirements. We ascertained to the extent possible that property physically retired or sold had been credited to appropriate plant accounts and that the plant accounts reflected physical additions constructed or purchased during the period. The preparation of construction and retirement work orders was not current at the date of the audit,

REA

Center County Electric Cooperative

therefore, plant values may be subject to adjustment because of unrecorded overhead and material charges and unrecorded retirements.

We also examined the provision for depreciation and reviewed charges and credits made to the reserve accounts. Depreciation has been established on the basis recommended by REA.

General Cash

In Bank	\$ 7,608.81	
Petty Cash	<u>100.00</u>	\$ <u>7,708.81</u>

Cash in the banks was verified by reconciliation with bank statements, and balances shown by the latter were directly confirmed with the depositories.

Petty cash was verified by count and traced back satisfactorily to November 30, 1946.

Construction and Installation Funds

\$ 4,584.36

Funds borrowed for construction and installation loan purposes, in the bank at the audit date, were verified by reconciling bank statements with the cooperative.

Temporary Cash Investments

\$ 51,581.06

Temporary cash investments, consisting of Series F, U. S. Bonds, purchased for \$48,988.00 and maturing at \$60,000.00 in 1965 and 1966, and coupon U. S. Certificate of Indebtedness costing \$2,101.06, bearing 7/8% interest, payable semiannually and maturing December 1, 1948, were examined. All were issued in the name of the cooperative and are held in a safety deposit box in the X. Y. National Bank. The earned increment on the bonds is \$492.00.

Notes Receivable

Less: Reserve for Uncollectible Notes	\$ 10,779.67	
	<u>500.00</u>	\$ <u>10,279.67</u>

Notes receivable were verified by examination and confirmed to the extent deemed necessary. The notes were all executed by consumers to finance wiring and plumbing installations or purchases of appliances. The latest maturity date is December 10, 1948.

REA

Center County Electric Cooperative

The following amounts were past due:

<u>Period</u>	<u>Amount Past Due</u>	<u>Unpaid Balance of Notes Involved</u>
1 to 29 days	\$ 250.64	\$ 450.35
30 to 59 days	229.03	796.25
60 to 89 days	690.37	1,062.61
90 days and over	<u>471.13</u>	<u>1,531.40</u>
Total Past Due	<u>\$1,641.17</u>	<u>\$3,840.61</u>

The probability of collecting past due notes was discussed with the manager in order to determine the adequacy of the reserve. We believe the amount provided is ample to cover normal losses.

<u>Accounts Receivable-Consumers</u>	\$ 10,946.11
<u>Less: Reserve for Uncollectible Accounts</u>	<u>500.00</u> \$ 10,446.11

Accounts receivable were verified by confirmation to the extent deemed necessary. We examined the accounts and obtained information from the manager and office personnel regarding delinquent accounts. Accounts in the amount of \$210.00 were more than 90 days past due. We believe that the reserve for uncollectible accounts is sufficient to cover any probable losses from this source.

Uncollectible account losses for 1946 were \$58.20, or 1/10 of 1% of the amounts billed.

Examination revealed that this account was overstated by \$375.26. During the course of this audit, an adjustment was made transferring the amount of \$375.26 to a deferred debit account in order to bring the control account into agreement with the actual accounts receivable outstanding. Comments with respect to this account are made in a subsequent section of this report.

<u>Accounts Receivable-Other</u>	\$ 5,656.32
<u>Less: Reserve for Uncollectible Accounts</u>	<u>45.00</u> \$ 5,611.32

The balances of the accounts receivable-other consists of:

Sales of material to members	\$1,500.00
Sales to other cooperatives	3,611.00
Sales to employees	<u>545.32</u>
Total	<u>\$5,656.32</u>

R/A

Center County Electric Cooperative

We verified the accounts receivable by test confirmation and such other auditing procedures as were considered necessary. Of accounts included in this category, amounts of \$36.12 were more than 90 days past due. The reserve for uncollectible accounts of \$45.00 is considered adequate.

<u>Material and Supplies-Electric</u>	\$ 4,597.41
<u>Material and Supplies-Resale</u>	13.11 \$ 4,610.52

The physical inventories, as taken and certified by the manager, were verified by a test count of selected items and by a reconciliation with inventory records. We checked prices, extensions, and footings on the inventory summaries to the extent deemed necessary, and found them to be substantially correct. All items listed on the inventory appeared to represent usable materials.

The inventories were priced at average unit prices, as shown on the perpetual inventory records, and the ledger accounts were adjusted to agree therewith.

The balance of the materials and supplies-electric accounts was found to be \$1,093.83 in excess of the value of the material shown by the physical inventory and the difference was recorded as a deferred charge, pending further investigation.

<u>Prepaid Expenses and Deferred Charges</u>	\$ 2,169.09
--	-------------

We examined all prepaid and deferred items. Prepaid insurance and other prepaid expenses were correctly stated and all are properly chargeable to future operations.

Included in this balance as a deferred charge is \$1,093.83 representing the amount of materials unaccounted for as indicated by comparison of the ledger balance for electric materials and supplies with the value of the materials on hand as evidenced by a physical inventory taken as of the audit date. This difference apparently arose from failure to report and record properly materials issued for construction and maintenance purposes. To account properly for this suspended balance, a review of all materials transactions and construction charges will be required.

Also included under this caption is \$375.26 which represents the suspended excess of the general ledger account for consumers' accounts receivable over detailed consumers' balances due November 30, 1946. We did not verify detailed transactions involving consumers' accounts, but ascertained that the major reason for this difference was failure to maintain accurate records of forfeited discounts and adjustments to consumers' bills. Necessary steps should be taken to determine the disposition of this amount.

REA

Center County Electric Cooperative

LIABILITIES AND OTHER CREDITS

<u>Long-Term Obligation to REA-Construction</u>	\$520,863.96	
<u>Long-Term Obligation to REA-Installation</u>	<u>6,746.21</u>	<u>\$527,610.17</u>

We verified the construction loan balance by examination of the notes and loan contracts on file in the cooperative office, and by comparison with quarterly statements from REA reflecting outstanding amounts.

A summary of the construction obligation follows:

Total long-term obligation		\$755,800.00
Less: Unadvanced funds		<u>162,871.48</u>
Net amount advanced to date		\$592,928.52
Less: Payments made when due	\$65,618.53	
Payments made before due date	<u>10,000.00</u>	<u>75,618.53</u>
Unpaid principal		\$517,309.99
Add: Accumulated interest deferred		<u>3,553.97</u>
Net construction obligation		<u>\$520,863.96</u>

All notes mature in 35 years from the dates of the notes except the note for \$260,000.00 which matures 25 years from the date of the note.

The installation obligation consists of eight notes, the unpaid balance totalling \$6,746.21, with due dates as indicated on Schedule 3. We verified the amount by examination of loan documents and other supporting evidence. Because payments on consumers' notes were delinquent, the cooperative found it necessary to use \$195.00 of its general funds in maintaining current payments to REA.

A further analysis of the long-term obligation is presented in Schedule 3.

Current and Accrued Liabilities

Accounts Payable	\$ 7,064.33	
Accrued Items	<u>478.68</u>	<u>\$ 7,543.01</u>

Accounts payable were verified by examination of supporting invoices and entries. As far as we were able to ascertain, all liabilities as of November 30, 1946 have been recorded on the books. We have examined subsidiary accounts payable records and have made inquiry concerning all current liabilities, and are satisfied that the accounts payable recorded in the books and shown on the balance sheet as of November 30, 1946 are correct.

REA

Center County Electric Cooperative

The composition of accounts payable is as follows:

Construction Accounts Payable	\$5,064.33
General Accounts Payable	<u>2,000.00</u>
Total	<u>\$7,064.33</u>

Accrued taxes, wages, and interest were verified by computation and checked with the records of the cooperative.

Other Liabilities and Credits \$ 2,419.99

Consumers' deposits, in the amount of \$2,419.99, were verified by examination of the accounting records and supporting evidence, and found to be correctly stated.

Contributions in Aid of Construction \$ 65.19

Contributions in aid of construction were verified by examination of the accounts and subsidiary records.

MEMBER AND PATRON EQUITIES

Membership Fees \$ 13,445.00

The total amount of membership fees was verified by tests in relation to the number of members billed for service and the record of members not receiving service. The amount shown appears to be correctly stated. No detailed verification was made of the individual member records.

Patronage Capital \$ 72,259.02

This comprises patronage capital of \$27,774.61, which has been assigned as credits to individual patrons; capital in the amount of \$19,936.56, which has been established as ready for assignment to patrons; and capital amounting to \$24,547.85 which is to be established as assignable at the end of the year. The last figure represents the operating revenues for the current year in excess of the cost of service and includes any adjustments relating to operations of the prior year which were too small to warrant application to capital already assigned.

Donated Capital \$ 10.00

This balance represents forfeited membership fees.

REA

Center County Electric Cooperative

Other Member and Patron Equities

\$ 22.65

Included under this caption are the following items:

Operating margins	(<u>\$1,284.61</u>)
Non-operating margins	707.26
Capital gains	<u>600.00</u>
Total	<u>\$ 22.65</u>

COMMENTS ON OPERATIONS

We made a general review and test check of the revenue and expenses for the period under examination and compared the revenue and expenses with those of the preceding calendar year.

Exhibit "B" presents a statement of revenue and expenses for the first eleven months ended November 30, 1946.

There follows a condensed comparative statement of revenue and expenses covering operations for the years 1944 and 1945, and a percentage comparison with the results obtained during the first eleven months of 1946. It will be noted that although there has been a consistent increase in the total amount of operating expenses, the ratio of such expenses to gross revenue improved during 1946. During the first eleven months of 1946 there was an increase in connected consumers from 1176 to 1294, or approximately 10 percent. In the same period, the number of miles of line increased from 500 to 600, making an increase of 20 percent.

COMPARATIVE STATEMENT OF REVENUE AND EXPENSES

	Year Ended				11 Months Ended	
	December 31, 1944*		December 31, 1945*		November 30, 1946	
Operating Revenue	<u>\$95,650.83</u>	100%	<u>\$102,368.26</u>	100%	<u>\$114,899.00</u>	100%
Deductions:						
Cost of Power	<u>\$25,011.07</u>	26.1	<u>\$ 26,430.88</u>	25.8	<u>\$ 27,216.97</u>	23.7
Other Operating Expenses	<u>25,211.83</u>	26.4	<u>29,225.43</u>	28.6	<u>30,367.75</u>	26.4
Depreciation	<u>9,465.71</u>	9.9	<u>11,372.39</u>	11.1	<u>12,988.54</u>	11.3
Taxes	<u>3,238.62</u>	3.4	<u>4,007.46</u>	3.9	<u>5,436.78</u>	4.7
Interest	<u>9,926.39</u>	10.4	<u>11,395.54</u>	11.1	<u>14,340.81</u>	12.5
Total Deductions	<u>\$72,853.62</u>	<u>76.2</u>	<u>\$ 82,431.70</u>	<u>80.5</u>	<u>\$ 90,351.15</u>	<u>78.6</u>
Operating Margins	<u>\$22,797.21</u>	<u>23.8</u>	<u>\$ 19,936.56</u>	<u>19.5</u>	<u>\$ 24,547.55</u>	<u>21.4</u>

*NOTE: Statement of revenue and expenses per operating reports submitted to REA, revised to include subsequent adjustments applicable to these years.

REA

Center County Electric Cooperative

GENERAL COMMENTS

Work Orders

Costs of work orders covering construction and retirement work had not been closed to the plant account for many months prior to the date of the audit. Also, work orders had not been prepared to evidence construction completed during the previous five months. It was observed that material, labor, and overhead costs are not being charged to work orders in accordance with procedures which will insure accuracy.

Materials and Supplies Records

Investigation revealed that the cooperative had on hand the necessary forms to maintain properly a system of control on the receipts and uses of materials, but laxity in keeping the records and following instructions has resulted in large discrepancies between the various physical inventories, the perpetual inventory cards, and the general ledger control accounts.

Collection Policy

The collection policy in connection with energy sales has proved fairly satisfactory, but the large amount of delinquent accounts covering house wiring and merchandise sales reflects a condition which merits attention.

Membership Records

Two membership records are maintained, one for memberships issued and the other for area coverage applications for membership. It is recommended that, as consumers are furnished with energy, the memberships be transferred to the membership issued account.

Interfund Obligation

Not appearing on the balance sheet, Exhibit A, is an interfund obligation of \$195.00 representing an amount due general funds from the installation loan payment account for payments made from general funds on the installation loan obligation.

Depreciation

Depreciation has been computed monthly on the plant accounts, but no provision has been made to provide for depreciation of the large amount of construction work recorded as in progress, but actually in service. An audit adjustment was made to correct this condition.

REA

Center County Electric Cooperative

Subsidiary Records

The audit revealed that practically none of the subsidiary records had been reconciled with the general ledger control, and that some bank accounts had not been reconciled for months.

Area Coverage Survey

The area coverage survey revealed that 283.5 pole miles are to be built to serve 1236 consumers who have signed contracts, which will add approximately \$2,500.00 additional revenue per month, or an average of \$8.82 per mile. The survey also disclosed 1157 prospective consumers.

Audit of Construction Transactions

An examination of REA construction fund receipts and disbursements showed the status of these funds to be as follows:

Total REA advances		\$592,928.52
Cash balance, November 30, 1946		<u>4,269.25</u>
Net disbursements		\$588,659.27
Unapproved disbursements representing:		
Amounts disbursed in excess of funds advanced for specific purposes	\$16,326.42	
Unallowable disbursements	<u>376.25</u>	<u>16,702.67</u>
Approved disbursements		<u>\$571,956.60</u>

Since the unallowable disbursements cannot be approved under the terms of the loan contract, the borrower should reimburse construction funds from general funds in the amount of \$376.25. As to the amounts disbursed in excess of the advances for specific purposes, it is recommended that budget adjustments and advances be requested on the next requisition to cover these overdisbursements.

Adjustments

All major adjustments were discussed with the manager. A schedule of all adjustments was provided and it was ascertained that the required entries were recorded in the books of the borrower at the conclusion of the audit.

REA

Center County Electric Cooperative

CERTIFICATE

In our opinion, the accompanying balance sheet and related statements of revenue and expenses, and capital credits and margins, subject to the foregoing comments, with particular reference to those concerning the accuracy of utility plant, accounts receivable, and the material accounts, present fairly the position of the Center County Electric Cooperative at November 30, 1946, and the results of its operations for the period January 1, 1945 to November 30, 1946, in conformity with generally accepted accounting principles, applied on a consistent basis.

Date:

Approved:

Auditor

Regional Head

REA

STATE 23 COUNTY

CENTER COUNTY ELECTRIC COOPERATIVE

TOWN, STATE

BALANCE SHEET AS OF NOVEMBER 30, 1946

ASSETS

Utility Plant (less reserve) (Schedule 1)		\$526,384.09
Current and Other Assets:		
General Cash	\$	7,708.81
Construction and Installation Funds		4,584.36
Temporary Cash Investments		51,581.06
Notes Receivable (less reserve)		10,279.67
Accounts Receivable - Consumers (less reserve)		10,446.11
Accounts Receivable - Other (less reserve)		5,611.32
Material and Supplies		4,610.52
Prepaid Expenses and Deferred Charges		2,169.09
Total Current and Other Assets		<u>96,990.94</u>
Total Assets		\$623,375.03

LIABILITIES AND OTHER CREDITS

Long-Term Obligation to REA (Schedule 3)	\$527,610.17
Current and Accrued Liabilities	7,543.01
Other Liabilities and Credits	2,419.99
Contributions in Aid of Construction	<u>65.19</u>
Total Liabilities and Other Credits	<u>537,638.36</u>

MEMBER AND PATRON EQUITIES

Membership Fees	\$	13,445.00
Patronage Capital (Schedule 2)		72,259.02
Donated Capital		10.00
Other Member and Patron Equities (Schedule 2)		<u>22.66</u>
Total Member and Patron Equities		<u>\$ 85,736.67</u>

REA

STATE 23 COUNTY

CENTER COUNTY ELECTRIC COOPERATIVE

TOWN, STATE

STATEMENT OF REVENUE AND EXPENSE

January 1, 1946 to November 30, 1946

Operating Revenues:		
Electric Energy Revenue	\$113,893.03	
Consumers' Forfeited Discounts and Penalties	833.81	
Miscellaneous Electric Revenues	172.16	\$114,899.00
Operating Revenue Deductions:		
Cost of Power	\$ 27,216.97	
Operating Expense	7,081.84	
Maintenance Expense	4,234.51	
Meter Reading and Collection Expense	4,232.09	
Uncollectible Accounts	90.00	
Demonstration Salary and Expense	367.79	
General Office Salaries and Expense	11,068.86	
Engineering, Legal and Accounting Services	360.00	
Insurance	935.97	
Directors' Fees and Mileage	840.00	
Miscellaneous Operating Expense	1,156.69	
Depreciation Expense	12,988.84	
Taxes - Property	4,636.01	
Taxes - Social Security	734.26	
Taxes - Other	66.61	76,010.34
Operating Margins (before interest deductions)		\$ 38,888.66
Non-Operating Margins:		
Non-Operating Revenue	\$ 466.71	
Non-Operating Revenue Deductions	306.66	160.05
Net Margins (before interest deduction)		\$ 39,048.71
Interest on Long-Term Debt		14,340.81
Net Margins for Period		\$ 24,707.90
Operating Margins		\$ 24,547.85
Non-Operating Margins		160.05
Net Margins for Period		\$ 24,707.90

REA

STATE 23 COUNTY

Schedule 1

CENTER COUNTY ELECTRIC COOPERATIVE

TOWN, STATE

UTILITY PLANT AS OF NOVEMBER 30, 1946

CLASSIFIED PLANT IN SERVICE

Intangible Plant:		
Organization	\$ 1,935.26	
Miscellaneous Intangible Plant	3,062.60	\$ 4,997.86
Distribution Plant:		
Land and Land Rights	\$ 13,237.16	
Poles, Towers and Fixtures	359,069.69	
Line Transformers	105,308.94	
Services	30,383.88	
Meters	29,181.26	537,180.93
General Plant:		
Buildings	\$ 3,181.49	
Office Furniture and Equipment	2,022.41	
Transportation Equipment	4,032.96	
Tools and Work Equipment	2,218.57	11,455.43
Total Classified Plant in Service		\$553,634.22

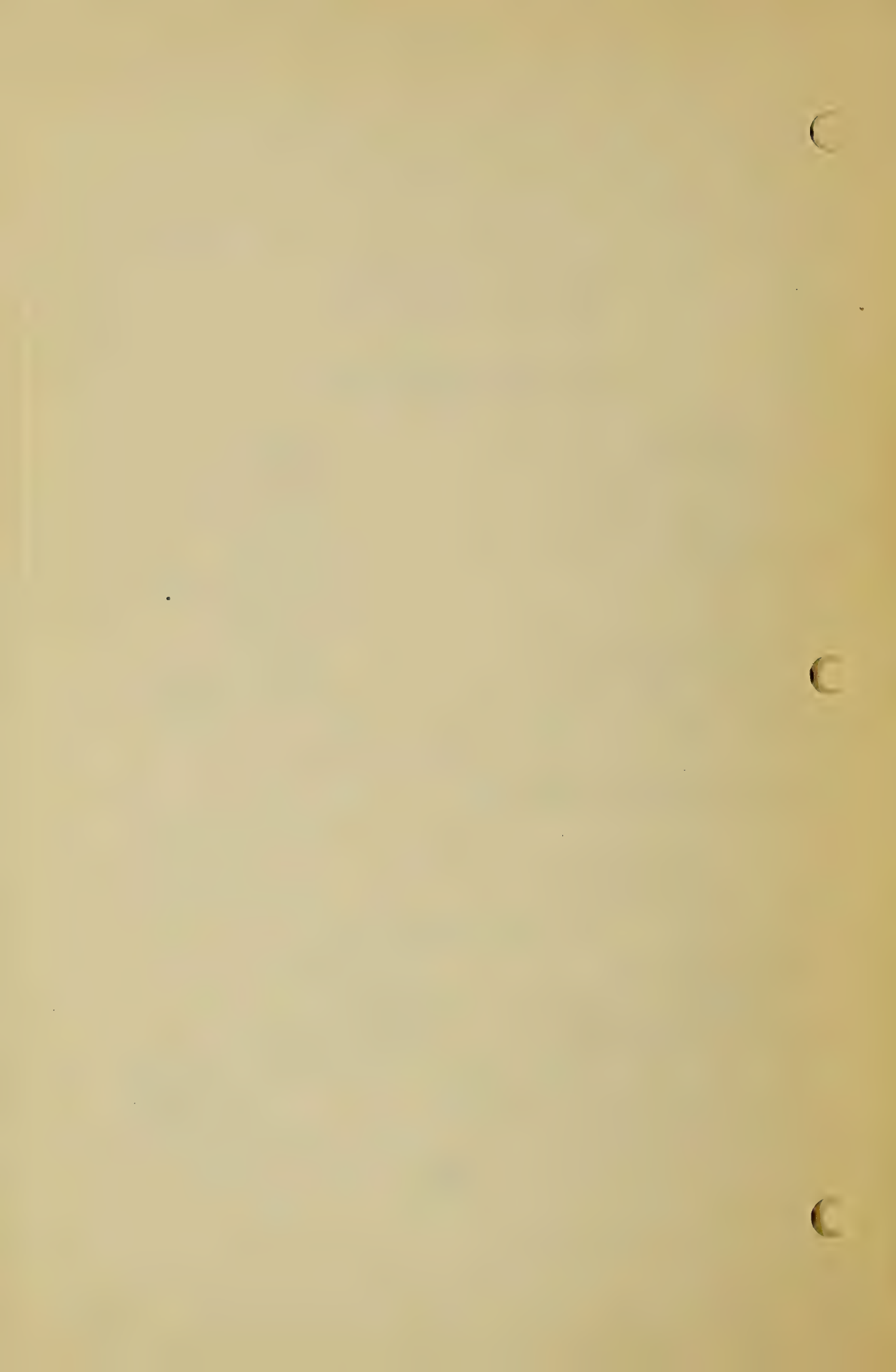
UNCLASSIFIED PLANT AND WORK IN PROGRESS

Unclassified Plant in Service	\$ --	
Contract Construction Work in Progress	--	
Work Order Construction Work in Progress	24.78	24.78
Total		\$553,659.00
Less: Donations in Aid of Construction		3,369.22
Total Utility Plant		\$550,289.78

LESS RESERVES FOR DEPRECIATION

Distribution Plant	\$ 16,238.52	
General Plant:		
Buildings	\$ 1,271.43	
Office Furniture and Equipment	1,075.48	
Transportation Equipment	3,185.87	
Tools and Work Equipment	2,134.39	7,667.17
Total Reserves for Depreciation		23,905.69
DEPRECIATED COST OF UTILITY PLANT		\$526,384.09

R/A



STATE 23 COUNTY

Schedule 2

CENTER COUNTY ELECTRIC COOPERATIVE

TOWN, STATE

PATRONAGE CAPITAL AND OTHER MEMBER AND PATRON EQUITIES AS OF NOVEMBER 30, 1946

	<u>Patronage Capital</u>		<u>Other Member and Patron Equities</u>			
	<u>Assigned</u>	<u>Assignable</u>	<u>Operating Margins</u>	<u>Non-Operating Margins</u>	<u>Capital Gains & Losses</u>	<u>Retired Capital Credits Gains</u> <u>Other Margins</u>
<u>Per Prior Audit</u>						
<u>January 1, 1945</u>	\$12,074.61	\$14,500.00	\$ (1,284.61)	\$ 324.21	\$ 500.00	
<u>Large adjustments affecting</u>						
<u>Years:</u>						
1943	\$ 500.00					
1944	(5,200.00)					
<u>Transfers</u>	<u>14,500.00</u>	<u>(14,500.00)</u>				
<u>Adjusted Balance</u>						
<u>January 1, 1945</u>	\$29,874.61		\$ (1,284.61)	\$ 324.21	\$ 500.00	
<u>1945 Net increase (decrease)</u>						
<u>including adjustments</u>		\$19,936.56		223.00	150.00	
<u>Adjusted Balance</u>						
<u>January 1, 1946</u>	\$29,874.61	\$19,936.56	\$ (1,284.61)	\$ 547.21	\$ 650.00	
<u>1946 (11 months), Net</u>						
<u>increase (decrease) in-</u>						
<u>cluding small adjustments</u>						
<u>not applied to assigned</u>						
<u>capital</u>		24,547.85		160.05	(50.00)	
<u>Capital retirements</u>						
<u>Adjusted Balance</u>						
<u>November 30, 1946</u>	<u>(2,100.00)</u>					
	\$27,774.61	\$44,484.41	\$ (1,284.61)	\$ 707.26	\$ 600.00	

NOTE: \$19,936.56 is to be assigned to patrons following this audit.

SUMMARY: Patronage Capital \$72,259.02
Other Member and Patron Equities 22.65

STATE 23 COUNTY

Schedule 3

CENTER COUNTY ELECTRIC COOPERATIVE

TOWN, STATE

LONG-TERM OBLIGATION TO REA

November 30, 1946

CONSTRUCTION OBLIGATION

Note	Date of Note	Principal Amount	Deferred Interest	Amount Unadvanced	Principal Repayments	Net Obligation
A	8- 2-47	\$260,000.00	\$	\$	\$61,025.46	\$198,974.54
B	7-20-38	44,800.00			4,687.27	40,112.73
C	10-20-38	101,000.00			9,905.80	91,094.20
D	10-15-41	85,000.00	1,472.40			86,472.40
E	3-10-44	40,000.00	1,207.85			41,207.85
F	5-26-45	40,000.00	873.72			40,873.72
G	6-26-46	185,000.00		162,871.48		22,128.52
		<u>\$755,800.00</u>	<u>\$3,553.97</u>	<u>\$162,871.48</u>	<u>\$75,618.53</u>	<u>\$520,863.96</u>

INSTALLATION OBLIGATION

Date of Note	Maturity Date	Amount of Note	Principal Payments	Unpaid Balance	Amount Delinquent
1- 1-44	1- 1-49	\$ 600.00	\$ 400.00	\$ 200.00	
5- 1-44	5- 1-49	932.42	466.21	466.21	
5- 1-44	5- 1-49	1,400.00	700.00	700.00	
11-20-44	11-20-49	1,500.00	600.00	900.00	
8- 1-45	8- 1-50	1,200.00	240.00	960.00	
8-10-45	8-10-50	1,000.00	200.00	800.00	
1-10-46	1-10-51	1,200.00	120.00	1,080.00	
8- 1-46	8- 1-51	1,640.00		1,640.00	
		<u>\$9,472.42</u>	<u>\$2,726.21</u>	<u>\$6,746.21</u>	

REA

THE FIELD ACTIVITIES REPORT

PAR. COMMENTS

- (306) In addition to the comments contained in the audit report, the auditor is required to submit a Field Activities Report, Form ADM-36. A sample report follows paragraph No. 310. Generally, the nature of the comments to be included in ADM-36 should be *based on facts relative to some condition existing in the borrower's office deemed of interest to REA in its dealing with the borrower.* Form ADM-36 should not merely duplicate comments made in the audit report; it may, for the benefit of REA, include and enlarge upon information presented in the comments for the borrower.
- (307) Conclusions, representing the auditor's opinion and based on facts disclosed by the audit and not included as part of the audit report comments, should be mentioned in the Field Activities Report. Facts regarding conditions existing in the borrower's office requiring action by other divisions of REA should be included in this class of comments. The auditor may make recommendations in matters which are not in his jurisdiction, but such recommendations must be supported by basic facts for the use of the responsible division. Comments regarding boards of directors need not be made unless pertinent to factual data contained in the audit report or in connection with an explanation of comments contained in ADM-36.
- (308) Personnel comments should be restricted to the manager, bookkeeper, and other office personnel who are responsible for the maintenance of accounting records. Auditors are not in position to comment on linemen and other outside employees. Statistical data related to the employees' background, salary, etc., should not ordinarily be included, as such information is generally available in the files of REA. Personnel comments should be confined to the auditor's observations made during the course of the audit regarding the employees' ability to function in their various capacities, their relationship with each other, and with the board and members. Also, the auditor may, if circumstances indicate the desirability, comment on their demonstrated ability to administer the cooperative's affairs in accordance with the policies and procedures recommended by REA.
- (309) Some of the matters which the auditor may include in the comments for the use of REA are the following:

PAR.

1. Any tax matters coming to the auditor's attention which, in his opinion, should be brought to the attention of the Administrator.
 2. Comments concerning the inadequacy or the completeness of insurance coverage as required by REA.
 3. Any deviation observed in the application of the approved schedule of rates charged to the consumers.
 4. Any particular banking or collection agency problems confronting borrowers which are deemed worthy of comment or action to assist borrowers in their solution.
 5. Comments concerning internal control.
 6. Any other matter which, in the auditor's opinion, requires attention or should be referred to another division for action.
- (310) The statements shown in the general comments should be consistent with those contained in the Field Activities Report. As an example, the general comments should not state that the accounting records have been well maintained and the Field Activities Report comments state that subsidiary records are not reconciled monthly with the general ledger, work orders are not prepared currently and perpetual inventory records are not kept posted. Whether the books and records have been well maintained depends on the reconciliation of subsidiary records, which includes the perpetual inventory, and the current status of the work orders. *Accompanying this report should be a copy of the written recommendations given to the borrower's personnel during the course of the audit.*

FIELD ACTIVITIES REPORT

(See reverse of last copy for instructions)

PERIOD COVERED - FROM AND TO:

January 1, 1945 to November 30, 1946

BORROWER DESIGNATION

State 23 County

TO

Joseph F. Marion, Chief

FROM - SIGNATURE AND DIVISION

J. C. Johns, REA Auditor, Finance Division

1. Center County Electric Cooperative, Town, State.
2. General Audit.
3. Complete general audit covering period January 1, 1945, to November 30, 1946. The audit required 22 work days; was started November 25, 1946, and completed December 23, 1946.
4. General instructions were given on reconciling the subsidiary records with general ledger controls. Instructions were given as to setting up more complete records for material accounting. Specific recommendations were given to the borrower on correction of certain records, a copy of which is attached.
5. It is recommended that the Management Division follow up on deficiencies noted in detail in this report.
6. It is our observation that the board is not sufficiently informed of procedures adopted by the manager. Board minutes are too brief. Instructions should be given regarding what should be recorded.

During the audit, the president and secretary-treasurer visited the office and discussed with the auditor certain phases of record-keeping and how improvements could be made in their general accounting procedures. In addition, they asked advice on whether the office was being operated properly and whether an office manager should be employed. The members of the board were advised that the auditor did not have the information necessary for proper consideration of these management problems and that he would refer in his report to their office problems for consideration of the Management Division.

7. James O. Rodgers - Manager

The manager has been with the cooperative since January 1, 1938. He has taken a correspondence course in electrical engineering and just recently received a State license as an electrical engineer.

It is apparent that Mr. Rodgers has not given sufficient attention to office procedures and records. The material records have not been properly maintained; work orders have been allowed to become delinquent; a strict collection policy has not been adopted; and certain transactions have not been recorded on the books. It is believed that if an office manager is employed, these conditions will be overcome.

FIELD ACTIVITIES REPORT

(See reverse of last copy for instructions)

TO

Joseph F. Marion, Chief

PERIOD COVERED - FROM AND TO:

January 1, 1945 to November 30, 1946

BORROWER DESIGNATION

State 23 County

FROM - SIGNATURE AND DIVISION

J. C. Johns, REA Auditor, Finance Division

The manager has fully cooperated with the auditor and was very helpful in supplying necessary information and records.

Mary Roberts - Bookkeeper

The bookkeeper has been with the cooperative since she graduated from business college in January 1943. She was first employed as a billing clerk and took over her present position about a year ago. Her books are very neatly kept. Most of the records were very well maintained, but some of the subsidiary records had not been reconciled. The bookkeeper expressed an eagerness to do a good job but stated that too many duties other than bookkeeping were imposed upon her, which made her neglect certain things she knew should be done.

Material Records

When materials had been withdrawn from stock, no record was made. At the suggestion of the bookkeeper, the manager called a meeting on December 6 of the lineman, work order clerk and bookkeeper, and asked the auditor to explain how the accounting for material should be handled. We explained the necessary steps, as outlined in the work order procedure. When the cooperative adopted the new work order procedure, it had ordered all the forms. It was agreed that, starting that day, the material charge and credit tickets would be used.

Work Orders

The work orders have not been prepared currently. The last work orders submitted to REA covered the month of December, 1945. Up to that time, the manager had made up the work orders but, because of the increase in work, could not continue to do so. He intended to employ a work order clerk but could not find anyone qualified for the position until November 1, 1946. Work orders for January and February, 1946, have been prepared by the new man and he is awaiting the approval of the field engineer before submitting them or making them up for the other months. The auditor advised him to continue to prepare them, as it would save time even if corrections would be necessary. It was explained that the holding up of the work orders was preventing them from getting additional and much needed advances.

Collection Policy

The borrower had not adopted a strict collection policy in the past in regard to notes receivable for house wiring. This was discussed with the manager and he said that he was reasonably sure that all delinquent accounts would be paid within the next month, as the members would be collecting on their sales of grain and stock at that time. At the suggestion of the auditor, he sent out notices of delinquency to all members on December 10, and had reduced the past-due amount to \$841.00 at the completion of the audit.

FIELD ACTIVITIES REPORT

(See reverse of last copy for instructions)

PERIOD COVERED - FROM AND TO:

January 1, 1945 to November 30, 1946

BORROWER DESIGNATION

State 23 County

FROM - SIGNATURE AND DIVISION

J. C. Johns, REA Auditor, Finance Division

TO

Joseph F. Marion, Chief

Delinquent Accounts Receivable - Consumers

The delinquent accounts receivable - consumers did not correctly reflect the condition of the accounts, as there were a number of membership fees that had not been applied against these delinquencies. Instructions were given for making the necessary adjustments.

Accounts Receivable - Other

During the course of the audit, the amount shown at the audit date as due from sales to other cooperatives was collected. The amount shown as due from employees was also paid. This represented charges for material furnished to the manager.

Transactions Not Recorded

It has been the practice of the manager to order certain appliances for board members and employees and to withhold payment of the invoices until collection is made from the purchasers. The collections are then deposited in the general fund and a check written to pay the invoices. No other phases of the transactions are recorded on the books.

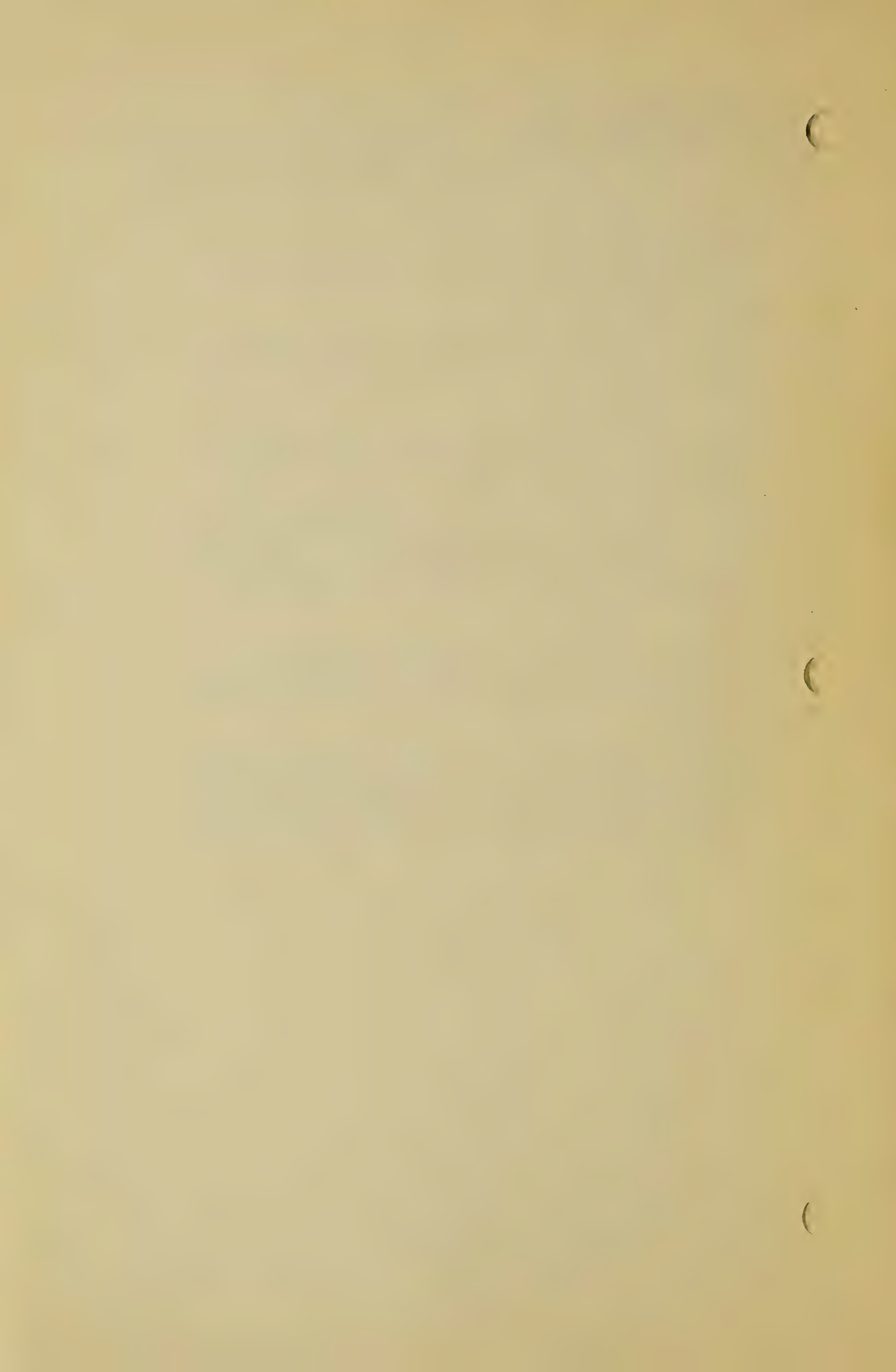
It was also found that cash received for scrap sales and patronage refunds on purchase of gas and oil had not been entered on the records. The manager was asked to give the reason for not showing this income in the records. He stated that this money was used for welfare purposes and saved the spending of general funds. It was recommended that all cash receipts be recorded and deposited in the bank and that all payments be properly accounted for. Also, it was recommended that all payments made by the cooperative be entered on the books.

Status of Federal Income Tax Exemption

Revenue derived from members as reflected by the accounts receivable was given a cursory check for purposes of determining the extent of such revenue in relation to income tax liability. It was apparent that member revenue exceeded the 85 percent necessary to meet exemption requirements.

Capital Credits

The Capital Credit plan was adopted by a meeting of the membership on January 20, 1945, to become effective January 1, 1945. The plan as adopted does not provide for distribution of margins existing at December 31, 1944. All necessary records are being maintained, as prescribed, and the use of the proper accounts was apparent. Actual assignments of margins have been made to members for the year 1945 only. No assignments were made for the year 1946 as a resolution had not been passed by the board for that year.



December 21, 1946

Mr. James O. Rodgers, Manager
Center County Electric Cooperative
Town, State

Dear Mr. Rodgers:

Subject: State 23 County

As a result of our audit of your books, we are presenting the following recommendations.

Recording of Transactions

It is the recommendation of REA that all financial transactions affecting the cooperative be recorded in the books to become a matter of record. All money collected should be deposited daily as received, and all payments should be made either by check or from the petty cash fund upon proper receipt.

Unallowable Disbursements

The amount of \$376.25 which represented payment made by REA Construction Fund Check No. 1265 to Union Material Company for replacement tools and work equipment was disallowed as an improper expenditure on Expenditure Report No. 65. Please write a check on the general fund reimbursing the REA construction fund for this amount.

Accounts Receivable - Other - Reimbursable Items

Included in the above account in the ledger is \$195.00 which represents the amount of general funds used in meeting payments on the wiring and plumbing loan when it became due. When sufficient collections have been received on the Notes Receivable for wiring and plumbing, a check should be written on the Cash - Installation Loan Payment Fund, payable to the General Fund. The entries to record the issuance and deposit of this check will eliminate the \$195.00 recorded in Accounts Receivable - Other and Accounts Payable.

Distribution of Approved Work Orders to Plant Accounts

During the audit a schedule was prepared by the bookkeeper and entries made to capitalize all approved work orders to date. In the future, as approved work order inventories are received from REA, the necessary entry should be made charging the plant account and crediting Account 100.6, Unclassified Electric Plant in Service.

Accounts Receivable - Suspense

The audit revealed a difference of \$375.26 between the balance of the consumers' ledger cards and the accounts receivable control account. This was transferred to a deferred debit account. If a thorough investigation fails to reveal the source of the discrepancy, board approval should be secured for writing the amount off to expense.

Very truly yours,

J. C. Johns, Auditor
REA Finance Division

PART V

AUDIT WORKING PAPERS

UNIFORM WORKING PAPERS

- (311) The audit working papers consist of exhibits, journal entries, schedules, analyses and summaries which the auditor prepares during his examination of the borrower's accounts and accounting records. These papers support the data in the financial statements and audit comments as well as indicate the extent and scope of the examination. They constitute the permanent records to be filed in the Washington office of REA for each audit completed. Reference is frequently made to these records for use in preparation of reports and clarification of accounting problems and questions relating to the borrower involved. These working papers also indicate the adequacy of the audit work completed and compliance of the auditor with the instructions regarding the particular assignment. It is essential, therefore, that these papers be presented uniformly and be standardized as much as possible. The extent of standardization possible along these lines has definite limitations which must be recognized. The extent of uniformity desired in working papers is to achieve maximum efficiency of the audit staff without sacrificing individual initiative, creative ability in planning effective methods of presentation of reports, and freedom in exercising individual judgment. The degree of standardization is, therefore, limited to establishment of minimum general requirements for preparation of audit working papers, minimum information to be presented, and recommended forms. The principles governing the preparation of working papers, which are set forth in this section, must be applied to the working papers for the specific assignment and the resulting report will be a uniform presentation insofar as it is possible to achieve uniformity. It is recognized that it is impossible to establish definitely the particular items which may appear in any account in the books of the borrower. It is not the intention of this handbook, therefore, to establish inflexible regulations for the preparation of working papers for each specific account in the borrower's records. However, it is possible to set forth the general principles to be followed in the preparation of all working papers and the information required by REA in the analyses or schedules of certain accounts. It is also desirable to present recommendations for the form of working papers with the understanding that conditions will necessitate the changing of the form to meet the requirements of the individual assignment.

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(312) The working papers submitted by the auditor are divided into two general classifications, that is, exhibits and schedules and analyses. The distinction in these two general classifications is functional, and as such, can be defined as follows:

1. Exhibits are prepared for the purpose of showing the end result of the auditor's examination of the borrower's records and are supported by the detailed information included in the schedules and analyses. The auditor should not confuse the exhibits included in his audit report with the financial statements, which are also termed "exhibits."
2. Schedules and analyses are prepared to show the verification of account balances appearing on the trial balance, and are arranged accordingly. These papers show the details supporting the exhibits.

(313) *General Principles for the Preparation of Working Papers.* The general principles involved in the preparation of audit working papers should be carefully followed in all instances. The procedures enumerated below are to be observed in the preparation of working papers.

1. Working papers should be prepared on standard size paper, 8½ inches by 14 inches, or paper which can be folded to this size.
2. Working papers should be securely bound at the top of the report with a metal fastener to prevent papers being lost in handling.
3. A cover of durable paper should be provided for the report and the name, address, and REA designation of the borrower, type of audit conducted, period covered by the audit, date of preparation and name of auditor or auditors conducting the examination should be typewritten on this cover.
4. The audit working papers should be indexed according to the uniform plan and arranged in the report in the order of the table of content.
5. All working papers must be neatly prepared and all writing and figures must be legible.

6. Each working paper should be identified by the name, address, and REA designation of the borrower concerned.
7. The title of the exhibit or schedule and the period covered by the audit should be shown on each paper as well as the index designation.
8. Only one subject should be covered on a working paper except in cases of analyses of accounts which can be satisfactorily prepared to show related accounts on one working paper. This statement refers specifically to the practice of using one-half of a sheet of working paper to schedule one account and the other half to schedule an unrelated account.
9. Only one side of a working paper should be used. If both sides are used, important items may be overlooked.
10. It is desirable to prepare audit working papers in pencil to facilitate making changes.
11. Each schedule or analysis should contain a brief statement of work done over the signature of the auditor.

(314) *Indexing Plan.* The indexing method is designed to provide a logical sequence of all audit papers, to make the location of specific papers easy, and to establish uniformity in arrangement of working papers for all audits. The audit index, prepared by the auditor to show the index designation and proper title of each exhibit, schedule and analysis included in the working papers, should be typewritten and placed in front of the papers, immediately under the cover. The working papers should be arranged according to the audit index, and must follow the uniform plan. *However, the auditor must bear in mind that working papers are not necessarily prepared in the order in which they appear in the index or table of contents.* In the light of the condition of the borrower's records, the circumstances of the assignment and the relationship between the various ledger accounts, the auditor will determine the sequence in which the working papers will be prepared.

(315) The indexing plan for exhibits, which are placed in the

front part of the file of working papers, is as follows:

1. The required exhibits are designated by predetermined letters in alphabetical order. Subsidiary exhibits to the principal exhibits will be designated by the letter assigned to the principal exhibit followed by an Arabic numeral. An example of a subsidiary exhibit is the journal entry exhibit ("A1") which supports the working trial balance ("A"). The predetermined exhibit designations are as follows:

Exhibits

- A - Working Trial Balance
- A1 - Audit Journal Entries
- A2 - Summary of Audit Journal Entries
- B - Summary of Changes in Utility Plant

2. The designations indicated above must be used for the exhibits to which they are assigned and cannot be used to designate any other exhibit.
3. If exhibits which are not included above must be prepared to meet the requirements of the specific audit examination, such additional exhibits should be designated by letters following alphabetical sequence starting with the first unassigned letter of the alphabet.

(316) The indexing plan for the schedules and analyses prepared for verification of specific accounts, is as follows:

1. These papers must be designated by the letter assigned to the particular classification of account involved. Papers supporting the principal working papers should be designated by the letter assigned to the major account classification, followed by an Arabic numeral. Papers supporting subsidiary working papers should be designated by the principal account classification letter, the subsidiary working paper Arabic numeral, and a letter, in alphabetical sequence.
2. The general plan followed in designating letters of the alphabet to the account

classifications is as follows:

Assets and other debits are designated by single letters. Liabilities and other credits are designated by double letters. Operating accounts are designated by numerals in consecutive order following the double letters of RR.

The letters are assigned in the order in which the accounts appear in the Uniform System of Accounts, starting with the lowest account number first. For example, utility plant account is the lowest account number according to the control account (account 100) and is assigned the letter A.

3. The letters assigned to the various classifications of accounts are as follows:

- A - Utility Plant
- B - Investments
- C - Long-Term Debt Fund
- D - Cash Accounts
- E - Temporary Cash Investments
- F - Receivable Accounts
 - F1 - Notes Receivable
 - F2 - Consumers' Accounts Receivable
 - F3 - Other Accounts Receivable
- G - Other Current Assets
- H - Materials and Supplies
- J - Prepayments
- K - Unamortized Debt Discount and Expense
- M - Preliminary Survey and Investigation Charges
- N - Retirement Work in Progress
- P - Other Deferred Debits

- AA - Memberships
- BB - Long-Term Debt
- CC - Notes Payable
- DD - Accounts Payable
- EE - Matured Interest and Principal
- FF - Consumers' Deposits
- GG - Taxes Accrued
- HH - Interest Accrued
- JJ - Other Accruals and Deferred Credits
- KK - Depreciation on Utility Plant
- LL - Contributions in Aid of Construction
- MM - Surplus Reserves

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- NN - Equities and Margins (Nonprofit Cooperative)
- NN - Surplus (Other than Nonprofit Cooperative)
- RR - Receipts and Costs (Nonprofit Cooperative)
- RR - Revenue and Expense Accounts (Other than Nonprofit Cooperative)

4. The above letter designations should be used to identify schedules and analyses for the account classification assigned and should not be used for any other account.

- (317) The following examples illustrate the application of the indexing plan to some related accounts:

Schedules:

- A1 - Analysis of Construction Work in Progress - Contract (a/c 100.31)
- A2 - Schedule of Incomplete Work Orders in Progress - Force Account (a/c 100.32)
- A2a - Analysis of Construction Work in Progress Force Account (a/c 100.32)
- A3 - Analysis of Electric Plant Held for Future Use (a/c 100.4)
- A4 - Schedule of Electric Plant Acquisition Adjustments (a/c 100.5)
- A5 - Schedule of Completed Construction Work Not Classified (a/c 100.6)
- A6 - Analysis of Intangible Plant (a/c 300 Series)
- B1 - Schedule of Other Physical Property (a/c 110)
- B2 - Schedule of Investments in Associated Enterprises (a/c.111)
- B3 - Schedule of Other Investments
- D - Reconciliation of All Cash Funds
- D1 - Scope of Detailed Audit of Cash Transactions

- (318) The title of the working paper should indicate whether it is a schedule or an analysis according to the following definitions of the term:

An "analysis" shows the details of the entries recorded in an account during the period covered

by the audit and is designed to bring out the important data in the transactions involved.

A "schedule" is a list of the individual items making up the balance in an account as of the balance sheet date and is prepared for the purpose of verifying the account balance. A schedule is also used to show the method and extent of verification of an account balance.

- (319) *Preparation of Adjusting Journal Entries.* During the course of an audit, the auditor will prepare some journal entries which may or may not be recorded on the books of the borrower. These entries are usually of two kinds, 1 - Adjusting Journal Entries, and 2 - Reclassifying Journal Entries.
- (320) The adjusting journal entries are those which are recorded on the books and accounts by the borrower. These comprise the majority of the audit journal entries and are prepared for the express purpose of correcting errors of posting or adjusting accounts. For the purpose of reference in the audit working papers, they are numbered consecutively beginning with #1 and posted in the audit adjustment column. However, if they are numerous (say more than three entries to any one account) they are summarized and the totals entered on the working trial balance.
- (321) The reclassifying journal entries are not recorded on books of the borrower and are used by the auditor to reconcile the balances shown by the books of account with the balances shown in the financial statements. These entries do not change the balances of the patrons' equities nor of the surplus account. They are numbered consecutively beginning with #101 and, as there are usually few entries, they are posted directly to the working trial balance.
- (322) There is another class of journal entries but the occasion for their use will rarely develop. These are proposed entries which will affect the patrons' equity accounts or the surplus account and which the borrower is unwilling or unable to record on his books of account. The facts pertaining to these entries should be shown in the working papers and commented upon in the auditor's report indicating what action by the borrower is recommended therewith. These entries should be numbered consecutively beginning with #201

but they are not posted to the working trial balance in the audit working papers.

(323) *General Standards for Audit Working Papers.* The information presented in the audit working papers should meet the standards set forth in this handbook to assure that the report contains all the essential information in an understandable manner. The following standards should be adhered to in the preparation of working papers:

1. Schedules or analyses must be prepared for all accounts listed in paragraph 325 appearing on the balance sheet if there has been any activity in such accounts; provided such activity resulted in an ending balance or involved transactions having a bearing on the financial position at the audit date or affecting accounts commented upon in the audit report. If no activity has occurred in the account since the last audit, a summary of the prior audit balance should be carried forward to the present audit working papers.
2. Working papers must be complete and should show sufficient detail to be understandable to an individual not familiar with the details of the records of the borrower involved.
3. Details such as names, date, descriptions, reference to original accounting evidence as to check numbers, invoice numbers, and other pertinent data must be shown on schedules which are designed to show the composition of an account balance.
4. Analyses must show general ledger references and amounts with the original entry reference, descriptions, amounts and accounting distribution comprising the amount of the general ledger entry. *Transcripts of ledger accounts are not analyses of such accounts and under normal conditions, should not be prepared.*
5. The details of the accounting distribution in analyses must be presented to bring out the desired information in a manner which accurately reflects the data considered pertinent in the account.

6. Audit adjustments affecting accounts should be indicated on the analyses or schedules of the accounts involved. If the supporting data for a journal entry appear on a working paper, reference should be made to journal entry number which is supported by that working paper.
7. Schedules or analyses of related accounts must be tied in with each other and must be in agreement. Related accounts should be reconciled on working papers when practicable.
8. Journal entry explanations must give reference to the original entry, or to working papers detailing the original entries involved. The reference to original entry shall include date, source of original entry, check numbers, names, descriptions, amounts and accounts affected by original entries.
9. Journal entry explanations must present adequate justification for making the adjustment by giving the details of the transactions involved.
10. When journal entry explanations refer to exhibits, schedules or analyses, such working papers must be identified and the explanation must include a statement to the effect that the borrower has a copy of the schedule or analysis in his file. The same amounts appearing in the journal entry shall appear on the exhibit, schedule or analysis supporting the entry, and must be identified on such supporting papers by the journal entry number adjusting the account.
11. Journal entries affecting prior accounting periods must be identified by the number of the account affected, and the year to which the adjustment is applicable.
12. The working papers should show the extent and scope of the auditor's examination of the accounting records by a statement of the verification made by the auditor for each balance presented.

MODEL WORKING PAPERS

(324) *Recommended Working Paper Forms.* The model working papers, illustrated in the appendix, show the recommended form of exhibits, analyses and schedules which are usually included in an audit report. Since these forms are designed to provide the information considered essential for a particular working paper, the auditor will find them adequate in nearly all cases, and should adhere to the standard presentation. However, if the auditor determines that the prescribed form of schedule or analysis will not be adequate for a particular situation, he should expand the recommended basic standard working paper to meet his requirement. The purpose of standards for working papers is to achieve uniformity but not uniformity at the expense of impairing the value of the individual audit report. The auditor should constantly strive to improve work methods through analysis of procedures and audit working papers. The field audit staff is encouraged to make suggestions for the betterment of the audit procedures.

(325) The analysis and schedules as *hereinafter* described for the following accounts are mandatory if there has been any activity, provided such activity resulted in an ending balance or involved transactions having a bearing on the financial position at the audit date or affecting accounts commented upon in the audit report. Care should be taken to read the text related to each exhibit and schedule since trial balance or other forms may be substituted under other circumstances.

- 100.31 - Construction Work in Progress - Contract
- 100.32 - Construction Work in Progress - Force Account (and tie-in with list of uncompleted work orders)
- 100.6 - Unclassified Electric Plant in Service (and tie-in with list of completed work orders)
- 120.1 - Cash-General
- 120.2 - Cash-REA Construction Fund-Trustee
- 122 - Petty Cash
- 123 - Temporary Cash Investments
- 124 - Notes Receivable
- 125.1 - Accounts Receivable Electric Consumers
- 125.2 - Other Accounts Receivable
- 132.2 - Other Prepayments
- 144 - Retirement Work in Progress

- 222.1 - Accounts Payable-General
- 222.2 - Accounts Payable-REA Construction
- 265.1 - Contributions in Aid of Construction
- 272 - Donated Capital
- 273.1 - Operating Margins
- 273.2 - Nonoperating Margins
- 273.3 - Capital Gains and Losses
- 301-303- Intangible Plant
- 310-336- Production Plant
- 340-349- Transmission Plant
- 350-363- Distribution Plant
- 370 - Land and Land Rights
- 371 - Structures and Improvements
- 391 - Electric Plant Purchased
- 392 - Electric Plant Sold
- 393 - Donations in Aid of Construction-Credit

- (326) The preparation of the remaining schedules is optional if the borrower's records are maintained in an acceptable manner and the audit reflects no adjustments necessary to the accounts being audited. Under such circumstances, the auditor may substitute the following certification in lieu of the schedules recommended:

Designation of Borrower

I hereby certify that the following accounts of the above-named borrower have been audited in the manner prescribed by the REA Handbook for Field Auditors; the audit reflects that the borrower has maintained his accounts in accordance with the REA Uniform System of Accounts and no adjustments to such accounts are required.

ACCOUNT NO.

AMOUNT

REA Auditor

Also, when minor adjustments are involved which may be readily identified, such as an omission or posting to a wrong account, simple schedules reconciling the accounts and clearly identifying the required adjustment may be substituted for the schedules recommended.

- (327) *Audit Table of Contents.* The table of contents, as shown, is a systematic listing of all principal

PAR.

exhibits and schedules representing the file of working papers. Not all of the exhibits and schedules may be required or be applicable to the particular assignment. Such working papers would, therefore, be omitted from the listing. If other exhibits or schedules are required they should be prepared and be included in the listing. These should be given a number which would follow those as shown on the form and filed under the lettered caption to which they apply. The general indexing plan as described in paragraphs 314, 315, 316 and 317 of the manual should be closely followed.

State 23 County
Center County Electric Cooperative
Town, State

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_____ 19__ to _____ 19__

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- 1a Auditor's Daily Time Report
- 2 Audit Report
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- A1 Audit Journal Entries
- A2 Summary of Audit Journal Entries
- B Summary of Changes in Utility Plant

SCHEDULES:

- A1 Construction Work in Progress - Contract - A/c 100.31
- A2 Incomplete Work Orders in Progress - Force Account -
A/c 100.32
- A2a Construction Work in Progress - Force Account - A/c
100.32
- A4 Electric Plant Acquisition Adjustments - A/c 100.5
- A5 Completed Construction Work Not Classified - A/c 100.6
- A5a Unclassified Electric Plant in Service - A/c 100.6
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- A9 Inventory of Tools and Work Equipment - Small - A/c
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- A10b Electric Plant Sold - A/c 392
- A11 Donations in Aid of Construction - Credit - A/c 393
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NN3	Miscellaneous Debits to Patrons' and Members' Equities - A/c 415

- (328) *Auditor's Assignment Schedule.* This form represents the authority for the auditor to proceed with the audit as assigned. Upon completion of the work the field auditor must sign and date the form as shown thereon. The "Time Required" must be in agreement with the auditor's daily time report and any discrepancies or variations must be stated by comments on the auditor's assignment schedule.

AUDITOR'S ASSIGNMENT SCHEDULE

Name of Borrower: _____		Assigned To: _____	
Address: _____ _____		Date Assigned: _____	
Designation: _____		Assigned By: _____ Assistant Regional Head	
Type of Assignment		Estimated Dates of Assignment:	
A. Balance Sheet Audit:		From _____ To _____	
Installation Assignment..... <input type="checkbox"/>		Actual Dates of Assignment:	
Operations Assignment..... <input type="checkbox"/>		From _____ To _____	
B. Detailed Audit Assignment..... <input type="checkbox"/>		Period Covered:	
C. Construction Audit..... <input type="checkbox"/>		From _____ To _____	
D. Special Audit Assignment:		Field Auditors Time Required:	
Contractor's and Engineer's Payments..... <input type="checkbox"/>		Total actual time incl. travel _____	
Special Report Assignment..... <input type="checkbox"/>		Payroll time reported _____	
Informal Visit..... <input type="checkbox"/>		Audit Report No. _____	
SPECIAL INSTRUCTIONS ON AUDIT ASSIGNED			
COMMENTS FOR NEXT AUDIT			
Audit Conducted By: _____		Date: _____	
Approved By: _____		Date: _____	
Reviewed By: _____		Date: _____	
Final Review By: _____		Date: _____	

- (329) *Auditor's Daily Time Report.* The time report must be included in the working papers for every assignment. It is maintained by the field auditor and the time devoted to the various activities as listed thereon should be recorded in multiples of *half hour periods*. The time devoted to the various activities should be distributed and entered on the schedule at the close of each day. Too often this is not done with the result that after a lapse of time the correct distribution will have been forgotten. Any estimate subsequently made may be incorrectly stated and will not serve the purpose for which this form is required. Time devoted to test check procedure should be allocated to the various items shown under Verification, Exhibits and Schedules.

State 23 County

Center County Electric Cooperative

Town, State

GRADE

(continuation)

- (330) *Exhibit A - Working Trial Balance.* This form must be prepared for all balance sheet audits, detailed audits, construction audits, and certain special assignments. The use of the additional columns for "Adjusted Trial Balance" as of audit date is optional.

State 23 County
Center County Electric Cooperative

Town, State _____ as of _____ 19____

[illegible]

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- (331) *Exhibit A₁ - Audit Journal Entries.* All journal entries prepared and used by the auditor in the current audit period must be included. The schedule shall be on an 8½" by 14" analysis paper similar to that of standard journal entry form. The entries should be listed in numerical sequence by AJE No., should show the account number and the account title and should reflect a full explanation of their purpose. The entries must be posted to the appropriate working papers and to the "Summary of Audit Journal Entries" or to the "Working Trial Balance" directly.

State 23 County
Center County Electric Cooperative
Town, State

AUDIT JOURNAL ENTRIES

as of June 30, 1950

ACCOUNT NO.	DESCRIPTION	DEBIT	CREDIT
134 402.1	-1- Unapplied Payments - Long Term Debt Miscellaneous Credits to Patronage Capital To transfer to proper account the payment made to U. S. Treasury on General Fund Check No. 362, (charged to Account 530.1 in error) dated November 25, 1949. This remittance was properly treated by REA as an unapplied payment on the principal of the B2 note.	200.00	200.00
228.6 230.2	-2- Accrued Income Tax Accrued Employees' Income Tax Withheld To transfer to proper account the amount of employees' salaries withheld for income tax purposes and not yet remitted to Internal Revenue. Account 228.6 is to be used for accrual of income tax liability incurred by an organization itself.	72.14	72.14
213.12 134	-3- Long-Term Debt - Construction Executed Notes Unapplied Payments - Long-Term Debt To re-apply payment made to the U. S. Treasury on General Fund Check No. 437, dated June 30, 1950, which actually represented payment of principal on A1 note and was so treated on the records of REA.	25.00	25.00

EXHIBIT - A1

- (332) *Exhibit A₂ - Summary of Audit Journal Entries.* This schedule need not be prepared if the number of journal entries to a single account does not justify it. The usual 14 column analysis paper should be used for this exhibit, each column to contain an account to be adjusted. The columns may be divided into three or four sections, depending upon the number of entries to be posted to one account. The columns should be numbered in sequence starting with the lowest number of the accounts affected. The debits should be entered in black and the credits in red with the totals thereof being carried forward to the working trial balance.

State 23 County
Center County Electric Cooperative
Town, State

SUMMARY OF

AUDIT JOURNAL ENTRIES

as of 19

A/C 100	A/C 134	A/C 213.12	A/C 228.6	A/C 230.2	A/C 401	A/C ---	A/C ---	etc.					
	1- 200.00 (3 - 25.00)	3 - 25.00	2 - 72.14	(2 - 72.14)	(1-200.00)								
A/C ---	A/C ---	A/C ---	A/C ---	etc.									
A/C ---	A/C ---	A/C ---	etc.										
A/C ---	etc.												

Figures in () indicate red figures

EXHIBIT A2

(333) *Exhibit B - Summary of Changes in Utility Plant.* The purpose of this exhibit is to show, in summary form, the changes made during the period of audit in the several accounts comprising the utility plant. The details are extracted from other schedules hereinafter described which are prepared in the process of verification of the additions, retirements and other changes in these accounts. This exhibit should not be prepared unless required in writing by authorization of the Chief of the Finance Division or unless the information shown therein is required by state or other regulatory body. In preparing this exhibit the following points should be observed:

1. The "Balance-Prior Audit" should be in agreement with the figures shown in the prior audit report
2. The "Additions" and "Retirements" columns should contain the actual net physical change in each of the several classified utility plant accounts. Corrections of erroneous book entries for additions and retirements made during the current audit period are to be added or deducted in the respective columns as the case may be.
3. The changes during the audit period in the unclassified plant accounts, except the electric plant acquisition adjustment account, should be shown in the net amount.
4. The write-offs of the acquisition adjustment account should be shown in the column for retirement and the net additions and other deductions should be inserted in a net figure in the column for additions.
5. The "Reclassifications" column is used for the purpose of reflecting the corrections in the account classifications between plant accounts, and of entries involving classifications of acquired plant or plants sold. The totals of the debit and credit columns under this heading should be equal.
6. All changes shown on this exhibit must be supported by and tied into summary figures of audit working papers analyzing the accounts involved.
7. Schedules need not be prepared for those accounts which reflect no changes during the present audit period.
8. The total of the "Retirement" column opposite the total classified plant should be reconcilable with the net amount of retirements charged to Account 144, as stated, by analysis of the retirement work in progress account (Schedule N, Retirement Work-in-Progress).
9. The "Total Utility Plant" as of the present audit date must be in agreement with the general ledger account after taking into account all the adjusting journal entries.

State 23 County
Center County Electric Cooperative
Town, State

SUMMARY OF
CHANGES IN UTILITY PLANT

From 19 to 19

ACCOUNT NO.		TITLE	BALANCE - PRIOR AUDIT JULY 1, 1949	CHANGES DURING AUDIT PERIOD			ADJUSTED BALANCE JUNE 30, 1950
				ADDITIONS	RETIREMENTS	RECLASSIFICATIONS DEBIT CREDIT	
100.1		Electric Plant in Service					
		Intangible Plant:					
301		Organization					
302		Franchises and Consents					
303		Miscellaneous Intangible Plant					
		TOTAL - Intangible Plant					
		Distribution Plant:					
350		Land and Land Rights					
363		etc. (Thru - Street Lighting and Signal Systems)					
		TOTAL - Distribution Plant					
		General Plant:					
370		Land and Land Rights					
379		etc. (Thru - Miscellaneous Equipment)					
		TOTAL - General Plant					
		TOTAL - CLASSIFIED PLANT					
391		Electric Plant Purchased					
392		Electric Plant Sold					
393		Donations In aid of Construction - Credit					
		TOTAL - ELECTRIC PLANT IN SERVICE					
		Unclassified Plant:					
100.31		Construction Work in Progress-Contract		(a)			
100.32		Construction Work in Progress-Force Account		(a)			
100.6		Unclassified Electric Plant in Service		(a)			
		TOTAL - Work in Progress					
100.2		Electric Plant Leased to Others		(a)			
100.4		Electric Plant Held for Future Use		(a)			
100.5		Electric Plant Acquisition Adjustments		(b)			
		TOTAL - UNCLASSIFIED PLANT			(c)		
		TOTAL UTILITY PLANT					
				(a) - Net Change - Dr. or (Cr.)			
				(b) - Net Additions or (Net Deductions)			
				(c) - Write - Offs.			

EXHIBIT B

(334) *Schedule A₁ - Construction Work in Progress - Contract.*

This schedule is an analysis of the general ledger account and should contain the nature of the charges and credits entered therein. The items must be properly checked out. If the borrower maintains subsidiary records in detail which can be checked and verified, a trial balance thereof with proper notations may be substituted. The borrower should also maintain the subsidiary records to determine the cost of contract construction which was paid from general funds and not reimbursed from REA Construction Fund. This record should be checked for accuracy. The audit adjustment column is used by the auditor as the medium for summarizing the adjustments which are necessary to clear certain items from the account. The total net balance as of the date of audit should agree with the general ledger account after including the auditor's adjusting journal entries, which should appear at the bottom of the schedule.

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[illegible]

SCHEDULE A 1

- (335) *Schedule A₂ - Incomplete Work Orders in Progress - Force Account.* This schedule is a trial balance of the subsidiary cost record of the incomplete force account work orders and inventories. The schedule may be prepared by the borrower but it must be checked by the auditor. A statement thereon must show the extent of his verification and the cost of the work orders, methods used in checking the accuracy of borrower's records and periods for which the detailed check was made.

A/C 100.32
INCOMPLETED WORK ORDERS IN PROGRESS
FORCE ACCOUNT

as of _____ 19____

WORK ORDER NO.		MATERIALS	LABOR AND OTHER			TOTAL

207

- (336) *Schedule A_{2a} - Construction Work in Progress - Force Account.* This schedule must be prepared in those cases in which the trial balance of the incomplete work order or inventory cost record is not in agreement with the general ledger account. This analysis is required in order to determine the adjustments necessary to bring the subsidiary records into agreement with the general ledger account. In making this analysis, the clearance to the Unclassified Electric Plant in Service should be summarized by materials, labor and other. These totals should then be applied to the analysis to determine the component cost remaining in this account, thereby forming the basis of the adjustments. The analysis could be prepared by the borrower but it must be verified by the auditor by means of a sufficient test-check of the items entered in the general ledger account.

- (337) *Schedule A₄ - Electric Plant Acquisition Adjustments.*
The details of the acquisition adjustments pertaining to each acquisition shall be kept separate. Those acquired during the previous periods should be brought forward from prior audit papers to which should be added those acquired during the current audit period. The acquisitions since the prior audit must be verified by the auditor. The amount amortized (debits and credits) must be checked for accuracy and propriety and tied into the accounts affected. Proper notations should be shown on the schedule as to the extent of the auditor's verification.

**State 23 County
Center County Electric Cooperative**

[illegible]

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- (338) *Schedule 45 - Completed Construction Work Not Classified.* This is a trial balance of the cost of the completed construction work orders which have not been reported on an approved inventory schedule or for which a final approved inventory has not been received. The schedule may be prepared by the borrower but it must be test-checked by the auditor and proper notations made thereon as to the extent of the check.

as of _____ 19____

SCHEDULE A *

- (339) *Schedule A5a - Unclassified Electric Plant in Service.* This is a listing of all construction work completed at the close of the audit, plus that completed during the current audit period, less the cost reflected on the final inventories or work orders approved by REA. This schedule must be compiled if the trial balance of the subsidiary record does not agree with the general ledger account. The borrower may keep a detail record of these entries or he may prepare such listings, in which event, the auditor must make a thorough test-check of the charges and credits to this account. The schedule should show the extent of the auditor's verification.

A/C 100.6

UNCLASSIFIED ELECTRIC PLANT

Center County Electric Cooperative
Town, State as of _____ 19____

[illegible]

- (340) *Schedule A6 - Intangible Plant.* This schedule should be prepared for the analysis of any of the following accounts which may reflect a change during the current audit period:

Organization (Account 301)

Franchises and Consents (Account 302)

Miscellaneous Intangible Plant (Account 303)

The column headed General Ledger should contain a summary of the balances carried forward from prior audit plus or minus the changes during the current audit period. The changes during the period are distributed to the "Additions" or "Retirements" columns as they apply or to the "Reclassifications" column if transfers to other plant or work in progress accounts are made from these accounts. Amortization of the various items in the account should be calculated on the adjusted balance and written off in accordance with REA procedure and approvals. The write-offs for each of the periods should be shown in separate columns so that the totals thereto will tie in with the amounts included in the operating revenue deductions. Summary totals should be prepared to supply the figures used in Exhibit B--that is, additions, retirements and/or reclassifications, if Exhibit B is prepared.

State 23 County
Center County Electric Cooperative
Town, State

[illegible]

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- (341) *Schedule A7 - Production, Transmission or Distribution Plant.* A schedule of this kind should be prepared for any of the accounts number 310-363, inclusive, in which a change has been made during the current audit period. The general ledger column should contain the changes in the account during the audit period, distributed over the columns applicable thereto. To this must be added the balance as of prior audit and the total should be in agreement with the general ledger balance as of audit date. If the breakdown of the balance as of the prior audit cannot be ascertained readily from the prior audit papers, no further effort to determine this breakdown should be made during the current audit. It should be noted that the column "Installation Costs" will not be required on any schedule except for the analysis of Line Transformers, Account 358, and on Meters, Account 360, and then only in those cases in which borrowers have not followed recommended procedure of including all such installation charges on work orders or inventories. The auditor may be able to determine the debits and credits to be entered in total in each column directly from the ledger account after applying an adequate check of the various items included. If so, the schedule may be arranged so that the columnar headings would be shown under "Description" and each column would contain an account included under this series. The net total of each column should be in agreement with the respective general ledger account balance. However, the auditor must state on the schedule, the extent of his verification of the account.

State 23 County

PRODUCTION, TRANSMISSION

OR DISTRIBUTION PLANT

Center County Electric Cooperative
Town, State as of.

[illegible]

SCHEDULE A 7

- (342) *Schedule A8 - General Plant and Depreciation.* This type of schedule should be prepared for general plant accounts, No. 370 and 371 and may be used for the non-mandatory schedule on accounts 372 through 379, except 377.1. A summary analysis of the depreciation reserve should be included on these schedules and reconciled with the expense account.

A/C 370 to 379 - 250.6
GENERAL PLANT AND DEPRECIATION

as of _____ 19____

DATE PURCHASED	DESCRIPTION	COST	MONTHS IN USE	MONTHLY DEPRECIATION RATE	TOTAL DEPRECIATION TO AUDIT DATE

221

- (343) *Schedule A₉ - Inventory of Tools and Equipment - Small.*
This schedule is an inventory of the tools and work equipment on hand as of the audit date. This should be prepared by the borrower and test-checked by the auditor. A comparison should be made with inventory list prepared in the prior audit to determine that the REA procedure in the handling of this account is being followed. This summary will present the information required for Exhibit B if prepared.

State 23 County
Center County Electric Cooperative
Town, State

A/C 377
INVENTORY OF TOOLS AND WORK EQUIPMENT

as of _____ 19____

DESCRIPTION	UNITS	UNIT PRICE	AMOUNT	

SCHEDULE A 9

PAR.

- (344) *Schedule A_{10a} - Electric Plant Purchased.* This type of schedule must be prepared to support any balance existing in the accounts for electric plant purchased. Any items not closed out as of the prior audit and still remaining on the books should be listed, as well as current items included in the balance.

State 29 County
Center County Electric Cooperative
Town, State

ELECTRIC PLANT PURCHASED
ACCOUNT 391

as of _____ 19 ____

DATE PURCHASED	DESCRIPTION	PURCHASED PRICE	ACQUISITION COSTS	TOTAL

SCHEDULE A 10A

PAR.

- (345) *Schedule A_{10b} - Electric Plant Sold.* This type of schedule must be prepared to support any balance existing in the accounts for electric plant sold. Any items not closed out as of the prior audit and still remaining on the books should be listed, as well as current items included in the balance.

State 29 County
Center County Electric Cooperative
Town, State

ELECTRIC PLANT SOLD
ACCOUNT 392

as of _____ 19____

DATE SOLD	DESCRIPTION	SALE PRICE	EXPENSES AND OTHER DEDUCTIONS	NET PROCEEDS

SCHEDULE A 108

PAR.

- (346) *Schedule A₁₁ - Donations in Aid of Construction - Credit.* This schedule is required when any balance is reflected in the construction donations account. The description column should reflect any available information as to sources of the donations and the construction work order or section to which applicable.

State 23 County
Center County Electric Cooperative
Town, State

25 of

19

[illegible]

229

- (347) *Schedule B₂ - Investments in Associated Enterprises.*
This schedule should be prepared by the borrower and the details thereof compared with the ledger account by the auditor. The evidence of investments reflected in the schedule should be physically examined or verified by confirmation. Upon such physical examination, the auditor should obtain a receipt from the borrower's personnel for the return of the securities inspected.

A/C 111
INVESTMENTS IN ASSOCIATED ENTERPRISE

as of _____ 19____

DATE	TYPE OF SECURITY OR MEMBERSHIP	NAME OF COMPANY	COST	VERIFIED BY EXAMINATION

231

(348) *Schedule B₃ - Other Investments.* This is a schedule of investments owned by the borrower at the beginning of the audit period and those acquired or sold during the period of the current audit. The securities on hand as of the audit date should be physically examined or verified by confirmation from the custodian. After inspection of securities or count of cash, the auditor should obtain the signature of an employee of the borrower on the working paper tabulating the assets which were inspected or counted under a statement substantially as follows:

"Received from _____, REA Auditor,
Securities as listed hereon, (or cash and cash
items counted in a total amount of \$ _____,
receipted invoices of \$ _____), at an aggregate
amount of \$ _____ recorded on the books as of
_____ 19_____, which was (were) counted (or
inspected) in my presence and returned to me intact.

- (349) *Schedule C - Miscellaneous Special Funds.* A schedule of this type may be used for each of the several cash funds which have been segregated for specific purposes. Separate decimal accounts are maintained for each type of fund and the heading of the schedule should be changed to correspond thereto. The funds must be checked for accuracy and propriety. In this connection, reference should be made to minutes of directors' meetings or to other authorizations for establishing and maintaining the funds. A reconciliation of the bank accounts should be included on Schedule "D" and the balance as of the audit date should be confirmed by the depository.

A/C 114
MISCELLANEOUS SPECIAL FUNDS

as of _____ 19____

Balance at beginning of audit period						\$
Plus - Receipts (Specific Requirements)						\$
Less - Disbursements (Specific Requirements)						\$
Balance as of audit date						\$
(Bank Reconciliation included on Schedule D)						

235

- (350) *Schedule D - Reconciliation of All Cash Funds.* All cash funds, including petty cash funds, should be included on this schedule. Where several bank accounts are used for one fund, a subtotal of all items in that fund should be shown, or should be detailed on a subsidiary schedule. Petty cash and change fund transactions during the period should not be shown except for increases and/or decreases in these funds. Reconciling items should be shown on supporting schedules giving details of items included, indexed with the schedules for the appropriate accounts.

State 23 County
Center County Electric Cooperative
Town, State as of

ACCOUNT NO.	TITLE OF ACCOUNT NAME AND ADDRESS OF BANK	BALANCE PER BANK STATEMENT (DATE OF AUDIT)	ADD: DEPOSITS IN TRANSIT (a)	DEDUCT: CHECKS OUT- STANDING (a)	ADJUSTED BANK BALANCE (DATE OF AUDIT)	LEDGER BALANCE (DATE OF AUDIT)	AUDIT ADJUST- MENTS	ADJUSTED LEDGER BALANCE (DATE OF AUDIT)	EXPLANATIONS

(a) List details on separate schedules to be attached hereto.

(a) List details on separate schedules to be attached hereto.

SCHEDULE D

- (351) *Schedule D1a - Scope of Detailed Audit of Cash Transactions.* This schedule should be completed by the auditor as evidence that a sufficient test-check of the cash transactions was made. If any errors are noted, appropriate comments should be made under "Remarks." However, if improper accounting treatment is noted, all transactions of the type in which the faulty treatment is disclosed should be referred to the Assistant Regional Head for a further examination.

SCOPE OF DETAILED AUDIT OF CASH TRANSACTIONS

PERIOD FROM _____ 19__ to _____ 19__	MONTHS CHECKED		
<p><u>CASH RECEIPTS RECORD - To what extent did you:</u></p> <ol style="list-style-type: none"> Trace daily receipts per cash book to bank deposits Trace cashier's stubs and cash tickets into the daily cash collection sheets Test footings of daily cash collection sheets and trace totals into the cash received record Test postings of cashier's stubs and cash tickets into the respective subsidiary records Test footings of: <ol style="list-style-type: none"> Net cash received column Credit columns Cross footings Test postings of account distribution columns into the general ledger accounts Scan all entries and verify the propriety of any unusual items not included in the test check 			
<p><u>CASH DISBURSEMENT RECORD - To what extent did you:</u></p> <ol style="list-style-type: none"> Examine paid checks for signature, bank cancellations and endorsements Trace cancelled checks to cash book entries and compare with payee, date and amount Account for pre-numbered checks Examine checks drawn to cash, banks or employees (except for salary checks) for propriety Examine invoices from vendors or other accounting evidence for payment Trace charges for consumer's checks returned by bank to subsequent collection and redeposits Test footings of: <ol style="list-style-type: none"> Net cash disbursed column Debit columns Cross footings Trace charges into the respective subsidiary records Test postings of account distribution columns with the general ledger accounts Scan all entries and verify the propriety of any unusual items not included in the test check 			
<p>Signed by _____</p> <p style="text-align: right;">Auditor</p>			
<p>_____</p> <p style="text-align: right;">Auditor</p>			

- (352) *Schedule D1b - Sample Letter to Banks Requesting Confirmation of Accounts.* This letter of confirmation should be sent to all banks with whom the borrower has done business during the audit period. The letter should request confirmation of the balance as of the date of the bank statement to which the bank account is reconciled and as of the date of cash count, if required.

UNITED STATES DEPARTMENT OF AGRICULTURE
RURAL ELECTRIFICATION ADMINISTRATION
Washington 25, D. C.

_____, 19____

To: _____

Dear Sirs:

In connection with the audit being made of the books and accounts
of _____,
we desire confirmation of the balances of accounts with you.

Please give us the information as stated on the reverse side hereof.
A return addressed (postage free) envelope is enclosed for your reply.

Yours very truly,
Rural Electrification Administration

Auditor, Finance Division

It will be appreciated if you will
comply with the request of the
REA Auditor.

_____ (Depositor)
_____ (Signature)
_____ (Title)

SCHEDULE D 1b (page 1)

PAR.

_____, 19____	
To: _____, REA Auditor	
Dear Sirs:	
Depositor _____	
At the close of business as of the dates indicated, our records reflected the following balances to the credit of the above depositor subject to withdrawal by check except as noted under 'Remarks':	
TITLE	BALANCES AT CLOSE OF BUSINESS
Yours very truly, (Bank) _____ By _____ (Title)	

SCHEDULE D 1b (page 2)

- (353) *Schedule D3a - Count of Cash Collected and on Hand.*
The cash on hand should be counted in the presence of the cashier or other employee responsible therefor. After the cash has been counted, the schedule should be signed by this employee as acknowledgment for the return of the cash and other items comprising the fund. The statement should be similar in form to that shown under Schedule B3. A reconciliation of cash collected and on hand should be made with the receipts from the audit date to the date when the cash was counted. The undeposited cash on hand should be traced to the subsequent deposit and the receivables affected thereby should be reconciled to prevent "kiting." It is not considered usually necessary to list the individual checks, money orders, collection slips, and receipts or vouchers. A tape may be prepared from the individual items and attached to substantiate these totals. The total of the schedules should be reconciled with the general ledger account.

COUNT OF CASH COLLECTED AND ON HAND

Date 19 0 AM
PM

<u>CURRENCY -</u>		Denomination	Count	Amount		
		\$ 50.00		\$		
		20.00				
		10.00				
		5.00				
		2.00				
		1.00				
				\$	\$	
<u>COIN -</u>		Denomination	Count	Amount		
		Dollars		\$		
		Halves				
		Quarters				
		Dimes				
		Nickels				
		Cents				
					\$	
Total - Currency and Coin						\$
<u>Checks and/or Money Orders:</u>						
<u>DATE</u>	<u>Maker</u>		<u>Bank</u>	<u>Amount</u>		
				\$		
Total Checks and/or Money Orders						\$
Total Cash on Hand						\$
Less - Change Fund						
Total Cash Collections						\$
<u>Collection Slips</u>						
<u>Date</u>	<u>Name</u>			<u>Amount</u>		
				\$		
Total Collection Slips						\$

Schedule D 3 a

- (354) *Schedule D3b - Count of Petty Cash Fund; and Schedule D3c - Count of Change Fund.* The cash on hand should be counted in the presence of the cashier or other employee responsible therefor. After the cash has been counted, the schedule should be signed by this employee as acknowledgment for the return of the cash and other items comprising the fund. The statement should be similar in form to that shown under Schedule B3. The auditor should note the age of checks, the IOU's and other receipts included, and should investigate all doubtful or irregular items. The balances should be reconciled with the general ledger account.

State 23 County
 Center County Electric Cooperative
 Town, State

COUNT OF PETTY CASH FUND

Date 19 6 AM
 PM

<u>CURRENCY: -</u>		Denomination	Count	Amount \$		
<u>COIN: -</u>				Amount \$		
<u>Checks and/or Money Orders:</u>						
Date	Maker		Bank	Amount \$		\$
<u>Receipts or Vouchers:</u>						
Date		Payee		Amount \$		\$
<u>Total - Per Count</u>						\$
<u>Total - Per General Ledger Account</u>						\$
<u>Difference (Overage or Shortage)</u>						\$

Schedule D 3 b (Petty Cash Fund)
 Schedule D 3 c (Change Fund - if separate from Collections)

- (355) *Schedule Dga - Adjusting Expenditure Report.* This schedule is prepared from the audit of the expenditures of the REA Construction Fund as reported by the borrower on their expenditure reports. The first page of the adjusting report should contain the classification of expenditures for the period of audit. Column 4, which contains the "Disbursements to be Audited," should represent the gross amount as shown in columns 2, 4, and 6 of the cooperative's expenditure report as of the audit date, less the approved disbursements as per the prior audit. Column 3 should reflect the disbursements which have been audited and were approved during the current audit. Columns 5 and 6 should represent the disallowances and suspensions, respectively, as listed in detail on pages 2 and 3 of this report.

ADJUSTING REPORT

PROJECT DESIGNATION _____

NAME OF BORROWER _____

DATE SENT _____ FOR THE PERIOD FROM _____ TO _____

DISBURSEMENTS BY PURPOSE		DEBIT AUDIT DISBURSEMENTS	CREDIT DISBURSEMENTS TO BE AUDITED	DEBIT TO BE REFUNDED	DEBIT SUSPENDED ITEMS	
(Column 1)	(Column 2)	(Column 3)	(Column 4)	(Column 5)	(Column 6)	(Column 7)
1. (a) Contractor - Sec.		98,900	100,000			
Sec.						
Sec.						
Sec.						
Sec.						
Sec.						
Sec.						
2. Meters		1,000	1,000			
3. Meter installation						
4. Transformers						
5. Legal fees - Sec.		1,500	2,000			
Sec.						
Sec.						
6. Miscellaneous legal expenses						
7. (a) Contract - Sec.			2,000		2,500	
Sec.						
Sec.						
Sec.						
Sec.						
Sec.						
(b) Force account						
8. Prerelocation expenses		500				
9. Right-of-way expenses						
10. General overhead						
11. Equipment						
12. Power and telephone agreements						
13. (a) Due from General Fund				1,000		
(b)						
(c)						
(d)						
(e)						
(f)						
(g)						
(ff)						
(gg)						
Closed Budget Items						
14. Material						
15. Labor and other						
TOTAL		101,500	105,000	1,000	2,500	

SCHEDULE D4a

- (356) *Schedule D4b - Adjusted Expenditure Report.* This report is a corrected expenditure report prepared by the auditor upon completion of his audit of the expenditures as reported by the borrower. The adjusted report reflects the adjustments developed in the preparation of Schedule D4a - Adjusting Expenditure Report. A copy of the adjusted report should be furnished to the borrower for submission to REA. The borrower's copy should bear the following statement:

Audited as of _____ , 19____
 Date Prepared _____ , 19____
 Prepared by _____
Auditor

ADJUSTED REPORT

PROJECT DESIGNATION _____
NAME OF BORROWER _____
DATE SENT _____ FOR THE PERIOD FROM _____ TO _____

DISBURSEMENTS BY PURPOSE	TOTAL ADVANCES	APPROVED DISBURSEMENTS	REFUNDS	SUSPENDED ITEMS	CASH BALANCE AT END OF AUDIT PERIOD
(Column 1)	(Column 2)	(Column 3)	(Column 4)	(Column 5)	(Column 6)
1. (a) Contractor - Sec.	350,000	248,500			101,500
Sec.					
Sec.					
Sec.					
Sec.					
Sec.					
Sec.					
2. Meters	12,000	11,000			1,000
3. Meter Installation					
4. Transformers					
5. Legal fees - Sec.	9,000	6,500			2,500
Sec.					
Sec.					
6. Miscellaneous legal expenses					
7. (a) Contract - Sec.	20,000	20,000		2,500	(2,500)
Sec.					
Sec.					
Sec.					
Sec.					
Sec.					
(b) Force account					
8. Preallocation expenses	500	500			- 0 -
9. Right-of-way expenses	11,000	9,000			6,000
10. General overhead					
11. Equipment					
12. Power and telephone agreements					
13. (a) Due from General Fund			1,000		(1,000)
(b)					
(c)					
(d)					
(e)					
(f)					
(g)					
(ff)					
(gg)					
Closed Budget Items					
14. Material					
15. Labor and other					
TOTAL	402,500	291,500	1,000	2,500	107,500

SCHEDULE 04b

- (357) *Schedule E - Temporary Cash Investments.* A form similar to Schedule B3 may be used for temporary cash investments.
- (358) *Schedule F1 - Notes Receivable.* This schedule may be prepared by the borrower, at least in part, but the auditor should check it for accuracy. The notes on hand should be tested by examination and compared with the listing. Confirmation should be obtained from the holders of the notes which are held for collection, held for safekeeping, or held as collateral. The total of the unpaid balances of these notes as of audit date should be in agreement with the general ledger control account.

- (359) *Schedule F2 - Analysis of Accounts Receivable-Electric Consumers.* This analysis is a summary of the monthly entries in the general ledger account and is to be prepared only in cases of detailed audits or upon instructions received from the Regional Head or from his assistant. By the use of this schedule any unusual debit and credit adjustments are determined for further review and investigation. The total of the "General Ledger" column should be in agreement with the control account.

A/C 125.1

[illegible]

SCHEDULE F 2

(360) *Schedule F2a - Aging of Consumers' Accounts Receivable.*

All borrowers prepare an analysis of the outstanding account balances as of the close of each month and a summary thereof is included in their monthly financial and statistical report submitted to REA. This analysis may be used by the auditor but the details must be checked, or verified by means of a test-check, if deemed adequate. After checking the borrower's analysis of the accounts as of the audit date, this schedule may be prepared in summary form but in sufficient detail to allow for insertion of information obtained by confirmation or other verification. Only in cases where a detailed audit is necessary should the individual balances of the current accounts be listed on the schedule. The totals of the several columns of the schedule should be reconciled with the general ledger balance, as follows:

Total Accounts Current		xxx
Accounts delinquent:		
1 to 29 days	xx	
30 to 59 days	xx	
60 to 89 days	xx	
90 days and over	<u>xx</u>	<u>xxx</u>
Total Debit Balances		xxx
Less: Credit Balances		<u>xx</u>
Balance per General Ledger		<u><u>xxx</u></u>

The schedule should bear a notation as to the extent of the auditor's verification of the accounts and balances as of the audit date.

AGING OF CONSUMERS' ACCOUNTS RECEIVABLE

State 23 County
Center County Electric Cooperative
Town, State

61

as of

[illegible]

PAR.

- (361) *Schedule F2b - Letter of Confirmation of Receivables.*
The auditor should send requests for confirmation of outstanding accounts to the extent he may deem necessary. All confirmation letters should be filed in the audit working papers under this schedule number, each one being numbered in sequence. The results of the confirmations should be summarized.

UNITED STATES DEPARTMENT OF AGRICULTURE
Rural Electrification Administration
Washington 25, D. C.

Dear Sir:

In connection with the audit of the books of
the following amounts are shown as the unpaid charges to your account as of
_____, 19____:

Membership Subscriptions
Notes Receivable
Energy Billings:

Forfeited Discounts:

Other Charges:

TOTAL

Please confirm the correctness of these charges or state the exceptions you
may take thereto. A return addressed (postage free) envelope is enclosed
for your reply. As this is a request for information, *please do not enclose
a remittance.*

REA Auditor

It will be appreciated if you will comply
with the request of the REA Auditor.

Title
.....

To

The amounts shown above as due on _____, 19____ are (Correct ☐
(Incorrect ☐
(if incorrect, please give details on reverse side.)

Dated

Consumer's Signature

SCHEDULE F 2b

- (362) *Schedule F₃ - Aging of Other Accounts Receivable.* This schedule may be prepared by the borrower but the details must be verified by the auditor. The total amount due must be in agreement with the general ledger control account. The aging of accounts under this caption should apply to the receivables other than the amounts due from officers and employees, but these latter amounts must be investigated to determine their propriety. The auditor may confirm the outstanding accounts by direct correspondence to the extent he may deem necessary.

State 23 County

AGING OF OTHER

ACCOUNTS RECEIVABLE

67

23 of

Town, State

[illegible]

SCHEDULE F 3

- (363) *Schedule H1 - Analysis of Materials and Supplies - Electric.* This analysis may be prepared by the borrower and verified by the auditor. This schedule should not be necessary except in cases of detailed audits or where material stock records are not maintained in support of the general ledger control account. The items in the "Salvage" column should be in agreement with the items returned to stock from Retirement Work in Progress. The credits in the "Construction Work in Progress" column represent the materials withdrawn from stock and used in construction work and the total thereof should tie in with the amount shown on the analysis of the construction work in progress. The inventory adjustments should be thoroughly reviewed and commented upon in the report.

State 23 County

ANALYSIS OF

Center County Electric Cooperative MATERIALS AND SUPPLIES - ELECTRIC

61

Town, State

[illegible]

SCHEDULE N 1

- (364) *Schedule H1a - Inventory of Materials and Supplies - Electric.* This is a copy of the last physical inventory taken by the borrower. This listing shall be furnished by the borrower and is the basis for the reconciliation with the general ledger control account. The auditor must make an adequate test-check of the extensions and footings and comparison with the stock records. The schedule should also show the extent of the auditor's verification.

- (365) *Schedule H₂ - Analysis of Materials and Supplies - Resale.* This analysis is a summary of the items of materials and supplies purchased for resale and should only be made in cases of detailed audits or upon instructions of the Regional Head or his assistant. The schedule can be prepared by the borrower but it must be checked by the auditor and a notation made thereon as to the extent of the verification. The inventory adjustments made during the period of audit must be thoroughly reviewed and comments made thereof in the audit report.

PAR.

- (366) *Schedule H2a - Inventory of Materials and Supplies - Resale.* As in the case with Schedule H1a, this is a listing of the last physical inventory taken by the borrower and furnished to the auditor. It is the basis for the reconciliation with the general ledger control account. An adequate test-check of the prices, extensions and footings should be made by the auditor. The schedule should also show the extent of the auditor's verification.

A/C 131.2

INVENTORY OF MATERIALS AND SUPPLIES - RESALE

as of _____ 19 _____

ITEMS			QUANTITIES WEIGHT OR UNITS	UNIT PRICE	INVENTORY AMOUNT	

269

PAR.

- (367) *Schedule H₃ - Inventory Certificate.* This inventory form must be completed and filed with the working papers in connection with all balance sheet audits. The items listed under Paragraph No. 7 should be in agreement with the general ledger account balances as of the date of the audit and tie in with the schedule pertaining thereto.

DEPARTMENT OF AGRICULTURE
RURAL ELECTRIFICATION
ADMINISTRATION

INVENTORY CERTIFICATE

SYSTEM _____
AUDIT REPORT NO. _____
AUDIT DATES _____
PERIOD COVERED _____

To REA Auditor:

I hereby CERTIFY that the materials and supplies on hand as of _____ 19____ as shown by the general books of account, are based on a physical inventory taken under my direction as of _____ 19____; that transactions between such date and _____ 19____ have been properly reflected in the accounts, and that to the best of my knowledge and belief:

1. All stocks belonging to the cooperative _____ 19____ and having any substantial value are included, but no obsolete, damaged or useless materials, supplies or merchandise are included at prices in excess of realizable value.
2. The quantities shown by the physical inventory are correct, were determined by actual count, weight or measurement, and were taken in substantially the same manner as the physical inventory at the close of the previous periods.
3. The entire inventory is the unencumbered property of the cooperative (excluding mortgage to REA) and does not include (a) stocks on consignment from others (b) unshipped stocks billed to members and/or consumers at or prior to _____ 19____ or (c) advance payments on account of purchase contracts for future deliveries.
4. Each item of inventory is priced on the basis of actual invoice cost plus freight and appropriate delivery and handling charges applicable thereto. This method of valuation conforms substantially to the basis used in pricing previous physical inventories.
5. The quantities of materials and supplies on hand as of _____ 19____ were compared with the stock records as of that date and the discrepancies were adjusted to the physical inventory amount as follows:

	Amount per Inventory	Amount per Stock Record**	Differences	
			Over*	Under*
Materials and Supplies -				
Electric.....	\$ _____	\$ _____	\$ _____	\$ _____
Resale.....	\$ _____	\$ _____	\$ _____	\$ _____
Total	\$ _____	\$ _____	\$ _____	\$ _____

- * These figures should be gross; Total Overages and Total Shortages.
** Before physical inventory adjustment, if any.

6. Liability for all items included in the inventory has been recorded in the accounts and purchase commitments were not in excess of normal requirements nor at prices in excess of current market prices.
7. The total amount shown on the general ledger as of _____ 19____ is \$ _____ and comprises the following:

Materials and Supplies - Electric.....	\$ _____
Materials and Supplies - Resale.....	\$ _____
.....	\$ _____
Total.....	\$ _____

Manager

CERTIFIED AS TO:

Quantities _____ - Title
Values, Prices and Valuation _____ - Title
Usable Condition _____ - Title

SCHEDULE M 3

- (368) *Schedule J1 - Prepayments - Insurance.* All insurance policies in force during the period of audit must be reviewed and the details checked with the entries in the general ledger accounts. This schedule is a listing of all policies in use during the audit period. If the borrower maintains a suitable insurance register which contains a record of all policies and reflects the proper distribution of the premiums paid, this schedule can be reduced to a summary form. Notation must be made on the summary schedule stating the extent of the auditor's verification.

PAR.

- (369) *Schedule J2 - Other Prepayments.* This schedule must be prepared whenever there is a balance in this account.

A/C 192.2
OTHER PREPAYMENTS

DATE	CHECK NUMBER	DESCRIPTION	AMOUNT PREPAID	WRITTEN OFF	BALANCE

275

- (370) *Schedule K - Unamortized Loan Expense and Schedule L - Extraordinary Property Losses.* A similar form of working paper schedule can be prepared for these two account classifications. The charges and expenses relating to the unamortized loan expense account in connection with each loan or obligation should be grouped and the write-offs should be based on the total cost for each loan and calculated at the rates specified by the board of directors. The ordinary property losses account, when authorized or directed by REA shall include such losses and damages not provided for by reserves and which would not reasonably have been foreseen and provided for. The amount of amortization on each schedule may be divided into separate columns to show the write-offs for each accounting period or portion thereof, or a summary may be made of the total write-offs during the present audit period. The write-offs should tie in with the Amortization of Loan Expense, Account 531, or the Property Losses Chargeable to Operations, Account 506. These schedules can be prepared by the borrower but the details shown thereon must be thoroughly test-checked by the auditor.

Town, State _____ as of _____ 19____

SCHEDULE K
SCHEDULE L

- (371) *Schedule M - Preliminary Survey and Investigation Charges.* The schedule may be a summary by types of charges and of the detailed information which the borrower should keep in connection with this account. Those charges pertaining to certain section or sections may be grouped. The write-offs should tie in with the amounts charged to Miscellaneous Income Deductions, Account 539.

State 23 County
Center County Electric Cooperative
Town, State

PRELIMINARY SURVEY AND
INVESTIGATION CHARGES

as of _____ 19__

[illegible]

SCHEDULE M

- (372) *Schedule N - Retirement Work in Progress.* This schedule is an analysis of the general ledger control account and contains the changes effected during the period of audit. This schedule should be prepared in summary form. The items shown under the plant accounts represent the cost of plant retired. The details of these columns should tie in with the retirements shown in the analyses of plant accounts and the totals should agree with the breakdown shown on Exhibit B, if prepared. The "Materials Salvage" column contains the credits entered for the value of line materials salvaged in the retirements and placed in stock for future use. These entries should be in agreement with the analysis of the material account, Schedule H1. The net amounts entered in the column for completed work orders represents the loss due to retirements and should agree with the charges to the reserve account. The total in the "Net Balance" column should be in agreement with the general ledger control account.

State 23 County
Center County Electric Cooperative
Town, State as of _____ 19 _____
A/C 144 RETIREMENT WORK IN PROGRESS

[illegible]

SCHEDULE N

- (373) *Schedule N1 - Incomplete Retirement Work Orders.* This is a trial balance of the cost ledger or other subsidiary record containing the retirement work orders which have not been completed. The total of the net balance column should be in agreement with the general ledger control account. The schedule may be prepared by the borrower but it must be checked by the auditor and a notation made thereon as to the extent of verification.

61

[illegible]

SCHEDULE N 1

- (374) *Schedule AA1 - Memberships Issued.* The schedule described is a summary drawn up from a review and analysis of the general ledger account and is to be prepared only in cases of detailed audits or upon instructions received from the Regional Head or from his assistant. The borrower should maintain a subsidiary record of the membership certificates issued and the trial balance thereof should be in agreement with the general ledger account.

A/C 200.1
MEMBERSHIPS ISSUED

as of _____ 19____

Schedule AA '

- (375) *Schedule AA2 - Memberships Subscribed but Unissued.*
If the borrower does not maintain adequate records, the borrower should be requested to prepare this schedule to reflect the subscriptions received for which certificates of membership have not been issued. The schedule should tie in with the receivable account which shows the balance unpaid on these subscriptions. Proper notations should be made on this schedule stating the extent of the auditor's verification and the condition of the subsidiary records. If proper subsidiary records are maintained, the borrower's trial balance thereof may be verified and reconciled with the general ledger account. Under these circumstances, the schedule would be a summary of the trial balance with a statement to the extent of the auditor's verification.

DATE OF APPLICATION	NAME		APPLICATION NO.	AMOUNT SUBSCRIBED (A/C 200.2)	AMOUNT PAID	SUBSCRIPTION RECEIVABLE (A/C 127)

SCHEDULE AA 2

- (376) *Schedule AA₃ - Patronage Capital and Patronage Refunds Payable.* This schedule is to be used for those cooperatives which have adopted the Capital Credits Plan. The schedule should show the balance of Account 224, carried over from the prior audit. To this shall be added or deducted the changes during the period of audit, showing the amounts set up for payment and amounts paid. The resulting balance should agree with the general ledger account.

- (377) *Schedule BB₁ - Long-Term Debt - REA Construction.* This schedule is a summary of the several general ledger account balances which comprise the long-term construction obligation as of the date of the audit. Total loans recorded should be reconciled with the loan contracts, and other balances reconciled with the most recent interest statements. The schedules should show correct deferred interest as of the audit date. Reconciliation between the amount on schedule and interest statement should be explained by footnote showing the accrued amount per the last interest statement and the additional accrual for the subsequent intervening period. For the purpose of reconciling this schedule with the general ledger accounts, total matured principal and total matured deferred interest as summarized on schedule EE should be deducted from column totals. The auditor should make a notation on the schedule as to the extent of his verification of the details and also comment whether all interest calculations have been checked and verified by the borrower.

State 23 County
Center Electric Cooperative
Town, State

SUMMARY OF
LONG-TERM DEBT - REA CONSTRUCTION

as of 19

NOTE	DATE OF NOTE	PERIOD COVERED	TOTAL LOAN CONTRACT	LESS: NOT COVERED BY NOTES	PRIN- CIPAL AMOUNT	LESS: UNAD- VANCED	PLUS: DEFERRED INTEREST	LESS RE- PAYMENTS	LESS: UNAPPLIED PAYMENTS	OPEN OBLIGATION
Principal			xxx							
Less: Repayments		xxx								
Matured Principal		xxx								
Balance Account 213.12		xxx								
Revised Schedule BBI to replace one now in the manual		xxx								

SCHEDULE 88 1

- (378) *Schedule BB₂ - Long-Term Debt - REA Installation.* This schedule is also a summary of the several general ledger account balances which comprise the Long-Term Debt - REA Installation Obligation. The auditor must reconcile the total outstanding with the most recent interest statement received from REA. The schedule must bear a notation as to the extent of the auditor's verification and whether all interest calculations have been checked and verified by the borrower.

State 23 County
Center Electric Cooperative
Tom, State

SUMMARY OF
LONG-TERM DEBT - REA INSTALLATION
as of 19

NOTE	DATE OF NOTE	PERIOD COVERED	TOTAL LOAN CONTRACT	LESS: NOT COVERED BY NOTES	PRINCIPAL AMOUNT	LESS: UNADVANCED	LESS: REPAYMENTS	OPEN OBLIGATION
Principal			xxx					
Less: Repayments		xxx						
Matured Principal		xxx	xxx					
Balance Account 213.11			xxx					
(Revised Schedule BB2 to replace one now in the manual.)								

SCHEDULE BB2

PAR.

- (379) *Schedule CC - Notes Payable and Interest Accrued.* The list of notes payable as of audit date may be prepared by the borrower. The details should be verified by the auditor and a notation made on the schedule as to the extent of his verification.

PAR.

(380) *Schedule DD - Accounts Payable.* This schedule may be prepared by the borrower but the details must be checked by the auditor. Comment should be made on the schedule as to the extent of the auditor's verification thereof.

A/C 222
ACCOUNTS PAYABLE

as of _____ 19____

[illegible]

297

- (381) *Schedule DD₁ - Liability Certificate.* This certificate is secured in connection with all balance sheet audits. It should be understood that a liability certificate is not a substitute for a proper examination by the auditor, but merely a precaution to provide written evidence that the auditor made proper inquiry from the management regarding the existence of liabilities not otherwise determinable from the records.

LIABILITY CERTIFICATE

SYSTEM _____
PERIOD COVERED _____

TO: REA Auditor.

In connection with your audit of the books and records of this organization as of _____, 19____ and with reference to your inquiries regarding the liabilities, we now confirm, to the best of our knowledge and belief, the information and explanations as follows:

1. All known liabilities of this organization at _____, 19____, in respect of purchases, salaries, wages, special compensation, taxes (including federal income taxes), legal fees, accrued expenses, unsatisfied judgments, special assessments levied for civic improvements, or of any other nature, were recorded as such on the books as at that date.
2. There were no law suits pending against the organization at the above-mentioned date nor at the present time which are likely to result in a loss affecting the period prior to _____, 19____, other than those for which an ample provision was made on the books of the organization as at that date. You have the opinion, in writing, of the organization's attorneys respecting such liability as may result from the suits of _____.
3. As at the above-mentioned date, this organization had no contingent liabilities in respect of accommodation endorsements, guarantees, pending claims, or of any nature except as follows:
4. This organization has not orally or otherwise acquired any options nor has it entered into any agreement to buy the assets or securities of other organizations except as follows:

Signed _____
Manager

Cooperative _____

- (382) *Schedule EE - Matured Principal and Interest on Long-Term Debt.* This schedule should contain the principal and interest amounts matured on the long-term debt accounts which have not been paid and for which no specific arrangement has been made for an extension of time in which to make payment. The schedule may be prepared by the borrower but a notation should be made thereon as to the extent of the auditor's verification.

A/C 225 - 226

MATURED PRINCIPAL AND INTEREST ON LONG-TERM DEBT

as of _____ 19____

DATE DUE	BILLED ON STATEMENT NO.	AMOUNT DELINQUENT	MATURED PRINCIPAL A/C 225)	MATURED INTEREST (A/C 226)	APPLICABLE TO DESIGNATED NOTES	

301

- (383) *Schedule FF - Consumers' Deposits.* If the borrower does not maintain a satisfactory subsidiary record of the deposits received and refunded, this schedule must be prepared. It may be prepared by the borrower and, if so, it must be checked by the auditor and a notation made on the schedule as to the extent of the verification. If proper subsidiary records are kept, the borrower's trial balance thereof may be verified and reconciled with the general ledger account. The schedules would, in such cases, be a summary of the trial balance with a statement to the extent of the auditor's verification.

as of _____ 19____

SCHEDULE FF

- (384) *Schedule GG₁ - Accrued Property Taxes.* This schedule should show the taxes paid for the last full taxable year and a reconciliation of the unpaid taxes with the general ledger account as of the audit date. Proper verification of the taxes paid and amounts of accruals should be made by the auditor. The period covered should be stated on the working paper schedule. A check should also be made with the prior audit working papers to ascertain whether any taxes are due but not paid. This schedule should be prepared in those cases in which adjustments of the tax accounts are necessary.

State 29 County
Center County Electric Cooperative
Town, State

A/C 228.1 - 507.1
ACCRUED PROPERTY TAXES

as of _____, 19____

Taxes paid in year _____		<u>xxx</u>
Accrued as of December 31, 19 _____		xxx
Estimate payable as of December 31, 19 _____ (using prior year's tax as basis and taking into consideration approximate increases due to line construction)		<u>xxx</u> xxx
Current period's accrual, per books	\$ xxx	
Estimate tax for current period based on prior year's actual tax	<u>xxx</u>	
Difference - current period		<u>xxx</u>
Total Difference (Journal Entry # _____)		<u>\$ xxx</u>

SCHEDULE GG 1

- (385) *Schedule GG2 - Social Security Taxes Accrued and Employees' Income Tax Withheld.* This is summary of the details comprising the balances of the several ledger accounts as of the audit date. The balances should be broken down by months, showing the amounts applicable to each month. The accounts should be reviewed by the auditor and the schedule should contain a statement as to the extent of his verification. This schedule should be prepared in those cases in which adjustments of the accrued amounts are necessary.

State 23 County
Center County Electric Cooperative
Town, State

SOCIAL SECURITY TAXES ACCRUED
AND EMPLOYEES' INCOME TAX WITHHELD
as of _____ 19__

MONTH			U.S. - S.S. UNEMPLOYMENT (A/C 228.2)	U.S. - S.S. OLD AGE BENEFIT (A/C 228.3)	STATE - S.S. UNEMPLOYMENT (A/C 228.4)	EMPLOYEES' INCOME TAX WITHHELD (A/C 230.2)

SCHEDULE GG 2

- (386) *Schedule HH1 - Accrued Interest and Interest Expense on Construction Loans.* This schedule is used to reconcile the interest accruals with the distribution of the interest charges. The analysis can be made in summary form and need not be detailed.

State 29 County
Center County Electric Cooperative
Town, State

A/C 219.9-229.1-590.1
ACCURED INTEREST AND INTEREST EXPENSE
ON CONSTRUCTION LOANS

		INTEREST ACCRUED - DEFERRED A/C 219.9			CURRENT INTEREST A/C 229.1			TOTAL	DISTRIBUTION OF CHARGES			
									WORK IN PROGRESS	EXPENSE - A/C 530.1	1949	1950
		NOTE A	NOTE B	etc.	NOTE A	NOTE B	etc.					
Balance June 30, 1949												
Accruals												
July												
August												
September												
October												
November												
December												
1950												
January												
February												
March												
April												
May												
June												
Total Accruals for Audit Period												
Sub - Totals												
Payments												
Interest Matured - Other Debits												
Total Debits												
Balance per books June 30, 1950												
Audit Adjustments												
Adjusted Balance												
Total Distribution												

- (387) *Schedule JJ - Other Accruals and Deferred Credits.*
Schedules similar to these should be included in all other credit accounts not provided for in other schedules. Separate schedules should be included for each account classification under this caption and the net balance thereof, as of audit date, should be in agreement with the respective general ledger account. The auditor should comment on the propriety of the balances in these accounts.

- (388) *Schedule KK1 - Computation and Reconciliation of Depreciation of Distribution Plant.* If a test-check of one month's depreciation on generating, transmission, and distribution plant reveals that the cooperative's calculation is reasonably correct, and the monthly entries to the general ledger account during the period of the audit reflect approximately the same amounts that are shown in the month which was test-checked, then the top portion of this schedule need not be prepared. In place of the words "(from this schedule)" on the bottom portion, the words "(general ledger test-checked)" can be inserted to indicate that the test mentioned above was performed. If the initial test-check of one-month's calculation indicates that there is a material difference, then the schedule would be completed in its entirety. In connection with the summary analysis of this account (the bottom portion of the schedule), the charges to the reserve accounts should tie in with the credits to the retirement account, Account 144, and all reconciling items should be fully explained. Credits to the account should be reconciled with the depreciation expense account.

State 23 County
Center County Electric Cooperative
TOWN, STATE

COMPUTATION AND RECONCILIATION OF
DEPRECIATION ON DISTRIBUTION PLANT
AS OF JUNE 30, 1950

Town, State		AS OF JUNE 30, 1950										
PLANT ACCOUNT NUMBER		BALANCE IN PLANT ACCOUNTS 1949						TOTAL DE- PRECIATION CHARGES 7/1/49 to 12/31/49	BALANCE IN PLANT ACCOUNTS 1950			DEPRECIATION CHARGES 1/1/50 to 6/30/50
		JULY	AUGUST	SEPTEMBER	OCTOBER	NOVEMBER	DECEMBER		(By Months, January through June 30, 1950)			
	Total Depreciable Plant											
	Monthly Rate .0029											
	Depreciation											
	Depreciation per											
	Books											
	Audit Journal											
	Entry No. —											
	Analysis of Reserve for Depreciation — Account 250.5											
	Balance in account 250.5 as of July 1, 1949											xxx
	Add: Credits — July 1, 1949 to December 31, 1949 (From this schedule)											xxx
	Less: Debits for period July 1, 1949 to December 31, 1949											xxx
	Balance in account 250.5 as of December 31, 1949											xxx
	Add: Credits — January 1, 1950 to June 30, 1950 (From this schedule)											xxx
	Less: Debits for period January 1, 1950 to June 30, 1950											xxx
	Balance in Account 250.5 as of June 30, 1950											xxx
	Reconciliation of Depreciation Expense:											xxx
	Depreciation Expense 1/1/49 to 6/30/49 per prior audit											xxx
	Depreciation per books 7/1/49 to 12/31/49 as above											xxx
	Unadjusted 1949 Depreciation Expense											xxx
	Audit Adjustment											xxx
	As adjusted 1949 Depreciation Expense											xxx

SCHEDULE KK 1

- (389) *Schedule LL1 - Contributions in Aid of Construction.*
This schedule should reflect the entries made with respect to contributions received and the amounts thereof applied to other accounts. The balances carried forward as of the beginning and end of the audit period should show the actual amounts received for each contribution, the portion transferred to other accounts and the net balance remaining in the account. The balances as of the beginning of the audit period should only comprise those items received which had not been transferred at that time.

- (390) *Schedule LL2 - Consumers Contributions for Debt Service.* This schedule is a summary of the amortization charges billed to consumers for the express purpose of servicing of long-term debt. The balance as of the beginning of the audit should be brought forward from prior audit working papers showing the billings for each of the fiscal years or periods up to that date. To this shall be added the monthly billings during the period of audit. If funds representing collections of these charges are segregated and placed in the separate cash account, the schedule should contain a reconciliation of the total billings with the balance on deposit in bank.

State 23 County
Center County Electric Cooperative
Town, State

A/C 265.2
CONSUMERS' CONTRIBUTION FOR DEBT SERVICE
as of _____ 19 _____

June 30, 1949	Balance per prior Audit					\$ 18,100.01
	Billings:					
	Year ending June 30, 1946				\$ 3,579.15	
	Year ending June 30, 1947				4,205.37	
	Year ending June 30, 1948				4,417.99	
	Year ending June 30, 1949				5,897.50	
	Total Billings				<u>\$ 18,100.01</u>	
1949	Billings during period of audit:					
July				\$ 491.62		
August				538.47		
September				535.16		
October				537.49		
November				536.40		
December				538.55		
1950						
January				544.35		
February				545.64		
March				546.74		
April				540.37		
May				543.82		
June				600.74		6,499.35
June 30, 1950	Balance per Ledger					<u>\$ 24,599.36</u>
	Reconciliation with Cash Account (#114.1):					
	Payments to REA -		Principal	Interest		
	Year - 1946		\$ 3,109.84			
	1947		3,984.27			
	1948		4,007.92			
	1949		4,332.57	\$ 206.26		
	1950		5,836.54	321.72		
	Total Payments		<u>\$ 21,271.14</u>	<u>\$ 527.98</u>	\$ 21,799.12	
	June Amortization on Collections in Transit (Received subsequent to Audit Date)				600.74	
	Cash on Deposit (A/C 114.1)				2,199.50	
	Total Billings				<u>\$ 24,599.36</u>	

SCHEDULE LL 2

- (391) *Schedule MM - Miscellaneous Margin Reserves.* This schedule must contain an analysis of the respective account and a summary of the items contained therein. The schedule should contain a statement that the account has been verified by the auditor.

A/C 258
MISCELLANEOUS MARGIN RESERVES
as of _____ 19____

319

- (392) *Schedule NN - Donated Capital.* This schedule is to be prepared to support any balance existing in the donated capital account. The schedule may start with the prior audit balance, provided the account has been scheduled to that date. The description column should be used to reflect details concerning the sources and nature of the donations.

23 of _____ 19 _____

SCHEDULE NN

- (393) *Schedule NN₁ - Earned Surplus.* This summary is to be prepared for a borrower which is not a nonprofit cooperative. The balance as of prior audit is carried forward from the prior audit papers. The "Net Operations" column shows the net results per the fiscal year-end closings of the revenue, expenses, and other income and deductions accounts. These closings are in accordance with the book entries that were entered on the books subsequent to the prior audit. The items in the columns for adjustments to surplus represent the entries in the miscellaneous credits to surplus and miscellaneous debits to surplus, accounts 401 and 414, respectively, and are broken down into the fiscal years to which they are applicable. The audit adjustments for the present period must be included so that the total of the adjusted balance column shall be in agreement with the amount carried on the balance sheet.

A/C 271
EARNED SURPLUS

as of _____ 19____

[illegible]

SCHEDULE NN 1

- (394) *Schedule NN1 - Patronage Capital and Other Member and Patron Equities.* This schedule is prepared for those borrowers which are nonprofit cooperatives. The "Operating Margins" column should contain the net credit balance of the operating accounts for each fiscal year of a borrower which has not adopted the Capital Credits Plan. If this plan has been adopted, the net debit balance of the operating accounts (costs in excess of receipts) will be transferred to the operating margins account, but the net credit balance of the operating accounts (receipts in excess of costs) will be transferred to the account of patronage capital assignable. The other columns of this schedule should contain the details in the respective general ledger accounts and the net balance should be in agreement with the ledger balance.

State 29 County
Center County Electric Cooperative
Tenn. State

	PATRONAGE CAPITAL		OTHER MEMBER AND PATRON EQUITIES				
	ASSIGNED	ASSIGNABLE	OPERATING MARGINS	NON OPERATING MARGINS	CAPITAL GAINS & LOSSES	RETIRED CAPITAL CREDITS-GAINS	OTHER MARGINS
<u>Per Prior Audit - July 1, 1949</u>	xxx	xxx	(xxx)	xxx	xxx		
Transfers, last six months 1949	xxx	(xxx)					
Capital retirements, last six months 1949	(xxx)						
Gains on retired capital							
From operations, last six months 1949		xxx		xxx	(xxx)	xxx	
Adjustments during last six months 1949:							
NW 2/3 affecting assigned capital for: - 1947	xxx						
1948	xxx						
NW 2/3 affecting capital assignable		(xxx)		(xxx)			
NW 2/3 affecting other equities							
<u>Adjusted Balance - January 1, 1950</u>	xxx	xxx	(xxx)	xxx	xxx	xxx	
Transfers, first six months 1950							
Capital retirements, first six months 1950							
From operations, first six months 1950		xxx		xxx	xxx		xxx

SCHEDULE NN 1

	PATRONAGE CAPITAL		OTHER MEMBER AND PATRON EQUITIES				
	ASSIGNED	ASSIGNABLE	OPERATING MARGINS	NON OPERATING MARGINS	CAPITAL GAINS & LOSSES	RETIRED CAPITAL CREDITS-GAINS	OTHER MARGINS
<u>Adjustments during first six months 1950:</u> NN 243 affecting assigned capital for: 1948 NN 243 affecting capital assignable NN 243 affecting other equities <u>Adjusted Balance - June 30, 1950</u>	<div>xxx</div> <div>xxx</div>	<div>xxx</div> <div>xxx</div>	<div>(xxx)</div> <div>(xxx)</div>	<div>xxx</div> <div>xxx</div>	<div>xxx</div> <div>xxx</div>	<div>xxx</div> <div>xxx</div>	<div>(xxx)</div> <div>(xxx)</div>

- (395) *Schedule NN₂ - Miscellaneous Credits to Surplus and Schedule NN₃ - Miscellaneous Debits to Surplus.* These schedules are prepared for a borrower which is not a nonprofit cooperative. The schedules should be prepared in detail and the entries in the account should be fully described. The amounts should be identified with the accounts affected and with the fiscal years to which they apply. The balances in the accounts as of the prior audit should be brought down and all transactions during the current audit period must be fully described.

MISCELLANEOUS CREDITS TO SURPLUS A/C 401
MISCELLANEOUS DEBITS TO SURPLUS A/C 414
as of _____ 19____

[illegible]

329

(396) *Schedule NN₂ - Miscellaneous Credits to Patrons' and Members' Equities and Schedule NN₃ - Miscellaneous Debits to Patrons' and Members' Equities.* These schedules are prepared for a borrower which is a nonprofit cooperative. These schedules should show all entries to the accounts in such details that the amounts are identified with the years and with the accounts to which they are applicable. Adjustments pertaining to operating revenue accounts and cost of electric service accounts should be credited to Miscellaneous Credits to Patronage Capital, Account 402.1, or debited to Miscellaneous Debits to Patronage Capital, Account 415.1. All credit items affecting nonoperating revenues and/or expense therewith would be credited to Miscellaneous Credits to Other Equities, Account 402.2, and all debit items would be charged to Miscellaneous Debits to Other Equities, Account 415.2. The entries by which the bookkeeper closes these accounts at the end of each fiscal year should be correctly applied:

1. If the amount of the adjustment is not large and does not affect the capital credits previously allocated, it should be closed to "Operations Clearing," Account 274, and applied to the appropriate current year's account.
2. If the entries affect a period for which patrons' credits have been allocated, and the amount is large enough to materially affect the allocations for that period, they should be closed to Patrons' Capital Credits, Account 201.1, and allocated to patrons.
3. If the adjustment applies to a period for which the patronage capital has not been assigned, it should be closed to Patrons Capital Assignable, Account 201.2.

The auditor should prepare adjusting entries closing the 402 and the 415 accounts, as of the date of his audit, in accordance with the above principles and the procedure outlined in the Uniform System of Accounts.

However, for audits covering periods not ending with the close of the accounting year, small adjustments which would be applicable to Account 274, Operations Clearing, should be closed instead to the appropriate revenue or expense accounts open on the books. The schedules should show complete details of the entries in the accounts during the period of audit and the items should be fully described. The summary should provide appropriate data for preparation of Schedule NN 1.

